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No. 99-1235

IN THE
SUPREME COURT OF THE UNITED STATES

GREEN TREE FINANCIAL CORP. -- ALABAMA and GREEN TREE FINANCIAL CORPORATION,
Petitioners,

v.

LARKETTA RANDOLPH,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

BRIEF *AMICI CURIAE* OF AARP AND THE NATIONAL CONSUMER LAW CENTER IN SUPPORT OF RESPONDENT

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BRIEF *AMICI CURIAE* OF AARP AND THE NATIONAL CONSUMER LAW CENTER IN SUPPORT OF RESPONDENT

INTEREST OF *AMICI CURIAE*[1/]

AARP is dedicated to addressing the needs and interests of people aged 50 and older. As the largest membership organization serving older Americans, AARP is alarmed by the rampant fraud and deceptive practices perpetrated in a broad range of marketplace transactions, because these acts

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[1/] The parties' consents have been filed with the Clerk of the Court. In compliance with Rule 37.6 of this Court, *amici curiae* AARP and the National Consumer Law Center state that no counsel for any party authored this brief in whole or in part and that no party or entity other than these *amici curiae*, their members or counsel made a monetary contribution to the preparation or submission of this brief.

disproportionately affect older consumers. AARP supports laws and public policies designed to protect their rights and to preserve the legal means to enforce them. AARP played an active role in the passage of recent amendments to the Truth in Lending Act ("TILA"), and participated in negotiations with industry and government representatives to improve disclosures and enhance substantive protections against abusive lending practices. AARP advocates for improved access to the civil justice system and supports the availability of the full range of enforcement tools, including class actions.

In recent years, AARP Foundation attorneys have represented countless older homeowners who have been victimized by abusive mortgage refinancings. These cases challenged: lender compliance with TILA disclosure obligations, including hiding a sixteen-point broker fee; charging a premium for credit life insurance of no value to the consumer; failing to provide the homeowner with a Notice of Right to Cancel; and failing to provide the three-day advance warning disclosure to a borrower with a high cost loan. Each of these loans was destined to go into default because the borrowers' mortgage payments ranged from 52 to 100 percent of their monthly incomes. The abusive lending practices described above are not diminishing but are becoming more widespread.

The effect of an arbitration agreement such as Green Tree's on these cases would have been devastating to the borrowers' ability to vindicate their TILA rights. Regardless of the fact that their arbitration costs ultimately might have been reimbursed, the initial outlay of fees would have barred these claimants from seeking redress.

The National Consumer Law Center ("NCLC") is a non-profit corporation established in 1969. One of its primary objectives is the provision of assistance to legal services attorneys, governmental agencies, and private attorneys in advancing the interests of their low-income and elderly clients in the area of consumer law. NCLC staff write and publish over thirteen legal treatises on various federal and state statutes that affect consumer law. In particular, *Truth In Lending* (4th

ed. 1999) and its earlier editions have provided insight and analysis of TILA for over two decades. This text was most recently relied upon by Chief Judge Posner in *Adams v. Plaza Fin. Co.*, 168 F.3d 932, 935 (7th Cir. 1999). For over twenty years, NCLC staff have provided oral and written testimony to Congress and the Federal Reserve Board on the propriety of statutory and regulatory changes to TILA and Regulation Z. NCLC staff also have been members of the Federal Reserve Board's Consumer Advisory Council.

Amici are filing this brief because mandatory arbitration agreements, such as Green Tree's, conflict with the public purpose of TILA and its private enforcement mechanism.

SUMMARY OF ARGUMENT

An arbitration clause that is silent regarding payment of arbitration fees and costs undermines the Congressional purpose of the Truth in Lending Act ("TILA"), if it imposes fee barriers that prevent claimants from vindicating their statutory rights. While companies that impose binding arbitration frequently tout it as a low-cost alternative to litigation, arbitration can be prohibitively expensive. When arbitration prevents a claimant from vindicating statutory rights conferred by a public interest statute like TILA, it impermissibly conflicts with TILA and its Congressional purpose.

Congress enacted TILA to provide consumers with information about the essential terms of their credit transactions and to deter deception and fraud in the credit marketplace. It has been a cornerstone of federal consumer protection law since its passage in 1968. TILA relies upon consumers acting as private attorneys general to police creditor compliance by providing individual and class remedies. The enforcement of TILA through damages provisions is made feasible by the Act's fee-shifting provision, which mandates the award of costs and reasonable attorneys' fees to a prevailing consumer.

The class action remedy is an essential component to enforcing TILA's protections and is a powerful deterrent to wrongful conduct. Indeed, class actions remain the only

realistic way for consumers with small monetary claims to vindicate their rights under, and to promote compliance with, TILA. Without class relief and mandatory fee-shifting, TILA would be reduced to nothing more than a mere nuisance to creditors, thus diminishing the Act's deterrent and remedial functions.

The Court has held that parties in arbitration are entitled to all substantive rights guaranteed by a statute such as TILA. The Eleventh Circuit's conclusion that an arbitration clause that imposes steep arbitrator or filing fees violates TILA's fee-shifting mandate is consistent with the Court's holdings and should be upheld.

ARGUMENT

I. CONGRESS ENACTED THE TRUTH IN LENDING ACT TO REGULATE CREDIT INDUSTRY PRACTICES AND PROTECT CONSUMERS.

The Truth in Lending Act [2] ("TILA" or "Act") has been a cornerstone of federal consumer protection law since its passage in 1968. TILA was enacted in response to the growing complexity in consumer credit in which many consumers were unable to discover the essential terms of their credit transactions, and in recognition that many unwitting consumers were routinely victimized by misrepresentations and fraudulent practices in the credit marketplace.[3]

Prior to 1968, consumers had no easy way to determine how much credit would cost or how to compare various loan products. Creditors did not calculate or advertise interest in a uniform way, nor was there a single system for defining what additional charges would be included in the interest rate. These

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[2] 15 U.S.C. § 1601 *et seq.*

[3] *See* H.R. Rep. No. 90-1040, at 2 (1968), *reprinted in* 1968 U.S.C.C.A.N. 1962; *Parker v. DeKalb Chrysler Plymouth*, 673 F.2d 1178, 1181-82 (11th Cir. 1982).

differences in computation significantly affected the cost to the consumer. For example, a three-year $6,000 car loan at 6% interest cost the consumer: $1,080 in interest if computed as an add-on rate; $1,317 in interest computed at a discount rate; and $570 in interest at a simple or actuarial rate. Consumers confronted with seemingly similar interest charges simply had no way to decipher which quoted rate of interest was the most expensive and could not compare terms and shop for credit.[4/]

Congress responded to this marketplace confusion, and sometimes outright deception, by enacting TILA. The statute represented an effort by Congress to strengthen competition among financial institutions and enhance the economic stabilization of the marketplace by the informed use of credit.[5/] This overarching public purpose was furthered by mandating the accurate, uniform, and meaningful disclosure of the costs of consumer credit.[6/]

The Act took a major step toward eliminating the interest rate deception noted above by prescribing a uniform calculation of interest as an annualized rate, by defining what kinds of credit-related charges should be included when calculating the annual percentage rate ("APR"),[7/] and by requiring that the total cost of these charges be disclosed as a dollar amount in the "finance charge."[8/] In Ms. Randolph's case, the creditor included a vendor's single interest insurance premium in the amount financed which should have been, but was not, included in the finance charge. This had the effect of artificially lowering the APR, making the loan look more

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[4/] *See* 109 Cong. Rec. 2027 (1963) (statement of Sen. Douglas).

[5/] 15 U.S.C. § 1601(a).

[6/] *Id.*; *Mourning v. Family Publications Serv., Inc.*, 411 U.S. 356, 377 (1973).

[7/] 15 U.S.C. § 1606.

[8/] 15 U.S.C. §§ 1605, 1638.

attractive to Ms. Randolph than it actually was.

TILA confers statutorily-created private rights affecting the public interest,[9] creates a system of disclosure that improves the bargaining posture of all borrowers, and requires strict technical compliance.[10] Green Tree violated TILA's mandatory disclosure scheme by failing to accurately provide Ms. Randolph with the essential terms of her credit transaction.[11] TILA's enforcement mechanism was designed precisely to empower consumers like Ms. Randolph to challenge creditors' wrongful conduct. Because of the importance of its remedial purpose, courts throughout the country have liberally construed TILA in favor of borrowers.[12]

A. TILA's Text, Purpose, and Legislative History Reflect the Pivotal Role of Private Attorney General Enforcement.

Congress intended that TILA's protections be enforced by consumers acting as private attorneys general.[13] Simply

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[9] *See Parker*, 673 F.2d at 1181; *Mills v. Home Equity Group, Inc.*, 871 F. Supp. 1482, 1486 (D.D.C. 1994).

[10] *See Parker*, 673 F.2d at 1181; *Smith v. Chapman*, 614 F.2d 968, 971 (5th Cir. 1980).

[11] *See* 15 U.S.C. §§ 1631(a), 1637-39; Regulation Z, 12 C.F.R. § 226.18 (1997). *See also In re Underwood*, 66 B.R. 656, 660 (Bankr. W.D. Va. 1986).

[12] *See Ramadan v. Chase Manhattan Corp.*, 156 F.3d 499, 502 (3d Cir. 1998); *Fairley v. Turan-Foley Imports, Inc.*, 65 F.3d 475, 479 (5th Cir. 1995); *Rodash v. AIB Mortgage Co.*, 16 F.3d 1142, 1144 (11th Cir. 1994); *Semar v. Platte Valley Fed. Sav. & Loan Ass'n*, 791 F.2d 699, 704 (9th Cir. 1986); *Bizier v. Globe Fin. Servs., Inc.*, 654 F.2d 1, 3 (1st Cir. 1981).

[13] *See Edwards v. Your Credit, Inc.*, 148 F.3d 427 (5th Cir. 1998); *McGowan v. King, Inc.*, 569 F.2d 845, 848 (5th Cir. 1978); *Aquino v.*

(continued...)

legislating required disclosures could not, by itself, compensate for the vast disparity in bargaining positions between consumers and lenders. The Act protects all consumers by deterring improper and deceptive behavior by all creditors.[14]

This private attorney general scheme includes the right to obtain actual damages, individual statutory damages, enhanced statutory damages for high-cost mortgages, class action damages, rescission, and an award of costs and attorneys' fees.[15] TILA represents a carefully constructed balance between the borrower's right to receive accurate and timely information about the cost of credit and the creditor's obligation to provide those disclosures without significant liability for small disclosure errors.[16] Petitioners and their *amici* advocate upsetting this statutory balance by allowing creditors to impose an arbitration scheme that thwarts consumers' ability to vindicate their rights as prescribed by TILA.

1. TILA Damages Effectuate Private Attorney General Enforcement.

From the outset, Congress primarily focused on the enforcement of the public interest in accurate disclosure through private attorney general lawsuits seeking statutory

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[13] (...continued)
Public Fin. Consumer Discount Co., 606 F. Supp. 504, 508 (E.D. Pa. 1985); *French v. Wilson*, 446 F. Supp. 216 (D.R.I. 1978).

[14] *See Edwards*, 148 F.3d at 432; *Jenkins v. Landmark Mortgage Corp.*, 696 F. Supp. 1089, 1092 (W.D. Va. 1988); *French*, 446 F. Supp. at 220.

[15] *See* 15 U.S.C. §§ 1640(a), 1635.

[16] *See* 15 U.S.C. § 1605(f).

damages.[17] Over the years, courts have uniformly held that TILA is primarily enforced through these private attorney general lawsuits which are expressly fostered by the statutory damages, mandatory attorneys' fees and cost shifting provisions.[18]

Several aspects of these provisions are significant. First, damages are mandatory even for technical violations. Second, to obtain statutory damages, the consumer need not show that he or she was deceived by the violation or suffered any actual damages;[19] this evidences the Congressional goal of furthering the public purpose of the Act through private enforcement. Finally, the consumer need not exhaust any administrative remedies or provide advance notice to a creditor or agency before instituting a lawsuit.

In the thirty two years since the Act's passage, Congress has consistently reaffirmed its commitment that private attorney general enforcement is critical to creditor compliance with the Act. In 1974, Congress specifically endorsed class actions by adopting class statutory damages[20] and added an actual

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[17] Actual damages were not included in the original damages provision. Consumer Credit Protection Act., Pub. L. No. 90-321, § 130, 82 Stat. 146 (1968) (*codified as amended in* 15 U.S.C. § 1640).

[18] *See Begala v. PNC Bank*, 163 F.3d 948, 950 (6th Cir. 1998); *Ramadan*, 156 F.3d at 502; *Edwards*, 148 F.3d at 432; *Rodash*, 16 F.3d at 1144; *Herrara v. First Northern Sav. & Loan Ass'n*, 805 F.2d 896, 902 (10th Cir. 1986); *Bizier*, 654 F.2d at 2.

[19] *See Zamarippa v. Cy's Car Sales, Inc.*, 674 F.2d 877, 879 (11th Cir. 1982); *Smith*, 614 F.2d at 968; *Dzadovsky v. Lyons Ford Sales, Inc.*, 593 F.2d 538, 539 (3d Cir. 1979).

[20] Act of Oct. 28, 1974, Pub. L. No. 93-495, 88 Stat. 1500 (*codified as amended at* 15 U.S.C.§ 1640(a)(2)(B)).

damages subsection.[21] In 1988, Congress imposed statutory damages for failing to provide consumers important information about home equity lines of credit.[22]

In 1994, Congress sought to curtail the rampant growth of predatory mortgage lending targeted at vulnerable consumers by offering special protections on "high cost" loans.[23] Congress deemed the new "high cost" disclosures and protections so important that it expanded the private attorney general scheme by creating mandatory enhanced statutory damages.[24] Finally, in 1995 Congress rejected industry efforts to undermine class actions, and doubled individual statutory damages in mortgage transactions.[25]

2. TILA's Fee-shifting Provisions Effectuate Private Attorney General Enforcement.

The mandatory award of costs and attorneys' fees to a prevailing borrower is one of the lynchpins of TILA's statutory enforcement. Fee-shifting gives an aggrieved borrower not only the right, but the ability, to act as a private attorney general.[26]

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[21] *Id.* at § 407(a) (*codified as amended* at 15 U.S.C. § 1640(a)(1)).

[22] Home Equity Loan Consumer Protection Act of 1988, Pub. L. No. 100-709, 102 Stat. 4725 (*codified as amended at* 15 U.S.C. § 1637a).

[23] 15 U.S.C. §§ 1602(aa), 1639.

[24] Enhanced damages under The Home Ownership Equity Protection Act ("HOEPA") are in addition to other statutory and actual damages. 15 U.S.C. §§ 1640(a), 1640(a)(4).

[25] Truth in Lending Act Amendments of 1995, Pub. L. No. 104-29, 109 Stat. 271 (*codified as amended at* 15 U.S.C. § 1640(a)).

[26] *See McGowan*, 569 F.2d at 848.

The consumer can afford to contemplate acting as a private attorney general because, if successful, costs and reasonable attorneys' fees must be awarded regardless of the size of the statutory damages recovery.[27] In contrast, unsuccessful plaintiffs are not penalized with an assessment of attorneys' fees and costs.[28] As Justice O'Connor observed, private attorney general actions "ensure the vindication of important rights, even when large sums of money are not at stake, by making attorney's fees available." *Farrar v. Hobby*, 506 U.S. 103, 122 (1992) (concurring). "Success must be measured not only in the amount of money damages but also in terms of the significance of the legal issues . . . and the public purpose served by the litigation." *Zagorski v. Midwest Billing Servs., Inc.*, 128 F.3d at 1165. Under TILA's fee-shifting statutory scheme, the enforcement costs that might otherwise be borne by a government bureaucracy are instead imposed on the creditor which has acted improperly.[29]

3. TILA's Class Action Provision Effectuates Private Attorney General Enforcement.

Congress consistently has recognized that class actions are essential to TILA's self-enforcement scheme. The debate over the importance of class actions emerged almost immediately after passage of this landmark consumer credit legislation. In the early years of TILA litigation, most courts were unwilling to certify a class because of the massive potential liability that would have resulted from aggregating the mandatory minimum

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[27] *See, e.g., Zagorski v. Midwest Billing Servs., Inc.*, 128 F.3d 1164 (7th Cir. 1997).

[28] *See* 15 U.S.C. § 1640(a)(3).

[29] *See, e.g., Kessler v. Associates Fin. Servs. Co.*, 639 F.2d 498 (9th Cir. 1981); *Harris v. Tower Loan, Inc.*, 609 F.2d 120 (5th Cir. 1980).

$100 statutory damages for all class members.[30] The inflexibility of minimum statutory damages, coupled with the Act's silence regarding class actions, created uncertainty as to Congress's intent regarding the use of class actions. As a result, courts imposed numerous procedural restrictions to prevent class liability for TILA violations.[31]

In its Annual Reports to Congress, the Federal Reserve Board expressed concern about the trend to disapprove TILA class actions.[32] The Board stated that "if this trend were to continue, the deterrent of potential class action liability which helps to ensure creditor compliance with the Act would be effectively lost."[33] The Board focused on the "prophylactic effect of the threat of class action exposure [which] elevates a possible Truth in Lending law suit from the ineffective 'nuisance' category to the type of suit which has enough sting in it to insure that management will strive with diligence to achieve compliance."[34] Congress agreed that "'potential class action liability is an important encouragement to the voluntary compliance which is so necessary to insure nationwide

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[30] *See* Ralph I. Rohner and Fred H. Miller, *Truth in Lending* 865-6 (Robert A. Cook, et al. eds., 2d ed. 2000).

[31] *Id.* at 866. *See, e.g., Shields v. First Nat'l Bank*, 56 F.R.D. 442, 446 (D. Ariz. 1972); *Wilcox v. Commerce Bank*, 55 F.R.D. 134, 138 (D. Kan. 1972); *Rogers v. Coburn Fin. Corp.*, 54 F.R.D. 417, 419 (N.D. Ga. 1972); *Ratner v. Chemical Bank N.Y. Trust Co.*, 54 F.R.D. 412 (S.D.N.Y. 1972); *see also Johnson v. Tele-Cash*, 82 F. Supp. 2d 264, 269 (D. Del. 1999).

[32] *See* 1972 F.R.B. Ann. Rep. on Truth in Lending 13-14; 1973 F.R.B. Ann. Rep. on Truth in Lending 9.

[33] 1973 F.R.B. Ann. Rep. on Truth in Lending 9.

[34] 1972 F.R.B. Ann. Rep. on Truth in Lending 13-14.

adherence to uniform disclosure.'"[35] At the same time, Congress expressly rejected the finance industry's proposal that TILA class actions be limited to those seeking actual damages or injunctive relief.[36]

Congress created a class action damages provision that carefully balanced TILA's purpose "to provide creditors with a meaningful incentive to comply with the law without relying upon an extensive new bureaucracy" with its concern that creditors not be subjected to enormous penalties for technical violations.[37] This provision specifically authorized class actions but limited the maximum damages awards. Far from indicating Congressional disapproval of the class action remedy, the limitation on statutory damages was the only mechanism that Congress deemed viable to express its manifest intent to *promote* class actions.[38] Indeed, through numerous amendments to TILA over the years, Congress has never deviated from this position.

Class actions have and continue to be a critical element in the enforcement of TILA. The right to aggregate claims for statutory damages has proven a potent ally to government efforts to prevent lenders from overstepping the bounds of

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[35] *See* S. Rep. No. 93-278, at 15 (1973), *quoting* 1972 F.R.B. Ann. Rep. on Truth in Lending 13.

[36] *Inaccurate and Unfair Billing Practices: Hearings on S. 1630 and S. 914 Before the Subcomm. on Consumer Credit of the Senate Comm. on Banking, Housing and Urban Affairs*, 93d Cong. 188 (1973) (statement of Robert Norris, General Counsel, National Consumer Finance Association).

[37] S. Rep. No. 93-278 to accompany S. 2101, Truth in Lending Act Amendments 14-15 (June 28, 1973).

[38] *See* S. Rep. No. 94-590 at 7-8 (1976), *reprinted in* 1976 U.S.C.C.A.N. 431. (When Congress amended the class action provision to increase available damages, it "wishe[d] to avoid any implication that the ceiling on class action recovery is meant to discourage use of the class action device.") *See also Johnson*, 82 F. Supp. 2d at 269.

TILA and straying into deceptive practices. In recent years, the payday loan industry has aggressively expanded from small local businesses to major national financial organizations.[39] These companies, whose loans are characterized by exorbitant rates, ranging from 261% to 782%,[40] adamantly had refused to provide TILA disclosures that would have revealed to borrowers their astronomical rates of interest.[41] Characterizing these transactions as "deferred presentments" or "cash leasing," these banks and finance companies sought to disguise the true nature of payday loans, asserting that TILA disclosures were unnecessary. Class action lawsuits propelled this issue to the foreground[42] and ultimately resulted in the Federal Reserve Board's issuing new Commentary[43] that stated the obvious – payday loans are consumer credit transactions and consumers

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[39] *See* Jean Ann Fox, Consumer Fed'n of Am., *The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry* 2-3 (1998); Jean Ann Fox, Consumer Fed'n of Am., *Safe Harbor for Usury: Recent Developments in Payday Lending* 4 (1999), www.consumerfed.org.

[40] Jean Ann Fox, *The Growth of Legal Loan Sharking*, *supra*, at 7; *see also Hamilton v. York d/b/a/HLT Check Exchange*, 987 F. Supp. 953 (E.D. Ky . 1997); *In re Miller*, 215 B.R. 970 (Bankr. S.D. Ky. 1997).

[41] *See, e.g., Turner v. E-Z Check Cashing*, 35 F. Supp. 2d 1042 (M.D. Tenn. 1999); *Hamilton*, 987 F. Supp. 953.

[42] *See, e.g., White v. Cash Emporium*, CA No. 98-269 (E.D. Ky. 1998); *Dortman v. Cash, Inc.*, CA No. 96-CV-188(R) (W.D. Ky. 1996); *Mumford v. McKenzie Check Advance*, Z-220-96 (Cir. Ct. Knox Cty., Tenn. 1996); *Goins v. Creditcorp*, V-96-175 (Cir. Ct. Bradley Cty., Tenn. 1996); *see also Johnson*, 82 F. Supp. 2d at 264.

[43] *Official Staff Commentary on Regulation Z § 226.2(a)(14)-2*, 65 Fed. Reg. 17129, 17130 (2000). The Board clearly stated that this commentary was not a change in the law.

are entitled to TILA disclosures that inform them of the true cost of that very expensive form of credit.[44/]

The public enforcement purpose of the class action remedy has been apparent from the outset. The class representative under TILA, who shepherds a case through complex litigation while receiving a smaller damages amount than in an individual case,[45/] cannot be said to be acting other than in the public's interest. Consistent with this notion, many TILA class action lawsuits effectively have raised and challenged abusive industry practices such as charging consumers for a deceptive insurance product,[46/] manipulating TILA disclosures to hide credit costs instead of disclosing them,[47/] and burying grossly inflated charges in the price of the goods sold.[48/] In the absence of class action lawsuits, many of these abusive practices would continue unabated.

[44/] Similarly in the arena of automobile "title pawn" loans, consumer lawsuits highlighted that industry's unwillingness to comply with TILA's disclosure scheme. *See. e.g., Barlow v. Quik Pawn Shop*, 992 F. Supp. 1299 (M.D. Ala. 1997); *In re Lannice Fryer*, 183 B.R. 322 (Bankr. S.D. Ga. 1995). The Federal Reserve Board amended its Commentary to emphasize that pawns loans are consumer credit transactions under TILA. *Official Staff Commentary on Regulation Z § 226.17(c)(1)-18*, 61 Fed. Reg.14956 (1996).

[45/] *See Bantolina v. Aloha Motors, Inc.*, 419 F. Supp. 1116, 1121 (D. Haw. 1976).

[46/] *See Adams v. Plaza Fin. Co.*, 168 F.3d 932 (7th Cir. 1999); *Edwards*, 148 F.3d 427.

[47/] *See Minnesota v. First Alliance Mortgage Co.*, C9-98-11416 (Dist. Ct., 2d Judicial Dist. Minn. Mar. 10, 1999) (order for final judgment); www.ag.state.mn.us.

[48/] *See Balderos v. City Chevrolet*, 214 F.3d 849 (7th Cir. 2000); *Walker v. Wallace Auto Sales, Inc.*, 155 F.3d 927 (7th Cir. 1998).

II. ARBITRATION AGREEMENTS SUCH AS GREEN TREE'S THAT PREVENT CONSUMERS FROM EFFECTIVELY VINDICATING THEIR STATUTORY RIGHTS UNDERMINE THE TRUTH IN LENDING ACT'S REMEDIAL PURPOSE.

The Court has recognized that "[b]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial forum." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985); *see also Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991). Congressional intent that a statute not be subject to a waiver of the right to a judicial forum can be gleaned from a statute's text or its legislative history, or from "an inherent conflict between arbitration and the statute's underlying purposes." *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 227 (1987).

Following this Court's direction, several federal courts have found arbitration provisions unenforceable when they undermined important statutory rights.[49/]

A. Arbitration Contracts That Require Claimants to Pay Fees Undermine TILA Enforcement.

An arbitration clause, like the one in the instant case, that is silent regarding payment of arbitration fees and costs undermines the Congressional purpose of TILA if it imposes fee barriers that prevent claimants from vindicating their statutory rights. While companies that impose binding arbitration frequently cite it as a low-cost alternative to litigation, many courts have recognized the real costs of

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[49/] *See, e.g., Shankle v. B-G Maintenance Management, Inc.*, 163 F.3d 1230, 1234 (10th Cir. 1999); *Paladino v. Avnet Computer Techs., Inc.*, 134 F.3d 1054, 1062 (11th Cir. 1998); *Baron v. Best Buy Co., Inc.*, 75 F. Supp. 2d 1368, 1370-71 (S.D. Fla. 1999), *appeal stayed*, No. 99-14028-E (11th Cir. June 2, 2000). *Cf. Cole v. Burns Int'l Sec. Servs.*, 105 F.3d 1465, 1484-85 (D.C. Cir. 1997).

arbitration and how the imposition of those costs and fees can prevent claimants from vindicating rights under statutes protecting public interests.

Cole v. Burns International Security Services, 105 F.3d 1465, 1480 (D.C. Cir. 1997), involved an arbitration agreement like Green Tree's which was silent as to costs. The parties in that Title VII civil rights case stipulated that arbitrators' fees are commonly $500 to $1,000 per day. The court found that an employee facing expensive filing and administrative fees, which are substantially in excess of the fees paid in federal court, is unlikely to pursue his or her statutory claims in an arbitral forum. *Id.* at 1484. In fact, the Court was:

> unaware of any situation in American jurisprudence in which a beneficiary of a federal statute has been required to pay for the services of the judge assigned to hear her or his case. Under *Gilmer*, arbitration is supposed to be a reasonable substitute for a judicial forum. Therefore, it would undermine Congress's intent to prevent employees who are seeking to vindicate statutory rights from gaining access to a judicial forum and then require them to pay for the services of an arbitrator when they would never be required to pay for a judge in court.

Id. (footnotes & citations omitted). To effectuate the liberal policy favoring arbitration agreements without impairing the claimant's statutory rights, the D.C. Circuit Court interpreted the arbitration agreement to require the employer to bear the full expense of the arbitral fees and costs. *Id.* at 1485.

The Tenth Circuit confronted a similar, but more intractable problem in *Shankle v. B-G Maintenance Management, Inc.*, 163 F.3d 1230 (10th Cir. 1999), where it found that an arbitration agreement requiring an employee to pay half of an arbitrator's fees, which included a $6,000 deposit, $250 per hour of arbitrator time, $125 per hour for arbitrator travel time, and $45 per hour for paralegal time, placed him:

> between the proverbial rock and a hard place – it prohibited use of the judicial forum, where a litigant is not required to pay for a judge's services, and the prohibitive cost substantially limited use of the arbitral forum. . . . B-G Maintenance required Mr. Shankle to agree to mandatory arbitration as a term of continued employment, yet failed to provide an accessible forum in which he could resolve his statutory rights. Such a result clearly undermines the remedial and deterrent functions of the federal anti-discrimination laws.

Id. at 1235. Because the fee-splitting provisions of the arbitration agreement explicitly conflicted with the statutory fee-shifting provisions, the *Shankle* court, unlike the court in *Cole*, was unable to craft a saving interpretation.

High up-front costs[50/] create a formidable barrier to a consumer's ability to vindicate statutory rights. These costs present a particular problem for the many consumers whose relatively small claims are substantially less than the cost of proceeding to arbitration. For this reason, arbitration clauses that are silent as to fees and costs should be unenforceable *unless* such clauses are interpreted to "ensure that [a consumer's] ability to vindicate her statutory rights [under TILA] will not be undone by steep filing fees, steep arbitrators' fees, or other high costs of arbitration." *Randolph v. Green Tree Fin. Corp.*, 178 F.3d 1149, 1158 (11th Cir. 1999). In the

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[50/] For example, the American Arbitration Association (AAA) requires that claimants who request an in-person hearing for a small claim pay all fees and costs. In disputes valued at between $10,000 and $100,000, a consumer must pay a filing fee of $500 to $1,250, a daily hearing fee of $150, a daily room rental fee of $150, and a portion of the arbitrator's fee of $100 to $350 per hour. AAA, *Commercial Dispute Resolution Procedures* (visited July 20, 2000) <http://www.adr.org/rules/commercial/commercial_rules.html>. *See also* John Vail, *Defeating Mandatory Arbitration Clauses*, 36 Trial 70, 71 (Jan. 2000); *Cole*, 105 F.3d at 1484 n.13.

absence of such a ruling from this Court, the Eleventh Circuit was not persuaded by Green Tree's statement at oral argument that the arbitration award might ultimately apportion the fees as directed by TILA. There is "no guarantee that a consumer successfully arbitrating under this clause will not be saddled with a prohibitive costs order, despite the small sum that is likely to be the object of the dispute in arbitrations of this kind." *Id.* Moreover, even an allocation of fees in accordance with TILA at the *end* of arbitration does not remove the entry barriers which ensue when a claimant must *advance* costs as a condition precedent to initiating the case.

Allowing Petitioners to impose such costs on consumers renders null the Court's statement in *Gilmer* that arbitration must not effect a loss of the "'substantive rights afforded by the statute. . . .'" 500 U.S. at 26 (*quoting Mitsubishi*, 473 U.S. at 614). In *Gilmer*, the standard practice was for employers to pay all the arbitration costs and fees under the NYSE and NASD rules.[51] The Court, therefore, was not confronted with the chilling effect upon a complainant being forced into an unreasonably expensive arbitration proceeding.

Petitioners and their *amici* simply dodge this issue. They fail to acknowledge the hardship – indeed the impossibility – for the average consumer to advance the fees that often far exceed the amount of the claim. Instead, they fast-forward the discussion down the time line and postulate a rosy scenario for the successful borrower in arbitration. They incorrectly argue that the right to costs and attorneys' fees is assured by the language of the arbitration agreement that " the arbitrator shall have all powers provided by the law and the Contract." *Randolph*, 178 F.3d at 1151. On the contrary, this language suggests that a great deal of discretion is accorded the arbitrator who need not follow the law. This slight of hand ignores the impact of up-front costs on borrowers. Arbitration that fails to clearly adopt the mandatory fee-shifting guarantees of TILA seriously undermines the statute's primary enforcement mechanism.

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[51] *See Cole*, 105 F.3d at 1483.

B. Arbitration Contracts That Preclude Class Actions Undermine TILA Enforcement.

The Court has endorsed the important role of class actions:

> The policy at the very core of the class action mechanism is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights. A class action solves this problem by aggregating the relatively paltry potential recoveries into something worth someone's (usually an attorney's) labor.

Amchem Products, Inc. v. Windsor, 521 U.S. 591, 617 (1997) (citation omitted).[52/]

TILA claims often are brought for small dollar amounts, to remedy deceptive practices aimed at the most vulnerable members of our society. Class actions were designed for this very situation, cases brought by "impecunious plaintiffs who allege similar mistreatment by a comparatively powerful defendant, one that . . . otherwise might get away with piecemeal highway robbery by committing small violations that were . . . beyond [the] ability or resources [of individual plaintiffs] to remedy." *Jackson v. Check' N Go, Inc.*, No. 99-C-7319, 2000 WL 782927, at *3 (N.D. Ill. June 13, 2000).

The class action remedy is not merely a procedural device; it is an important *substantive* right under TILA.

> Whether or not a class action is available as a remedy is a substantive issue relating to congressional intent. . . . It is hard to believe that

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[52/] *Accord Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 161 (1974) ("A critical fact . . . is that petitioner's individual stake . . . is only $70. No competent attorney would undertake this complex antitrust action to recover so inconsequential an amount. Economic reality dictates that petitioner's suit proceed as a class action or not at all.").

> the question of whether TIL damages should be collected en masse is no more than a procedural issue.... Any uncertainty on this score should be resolved by the specific class action recovery provisions in section 130(a)(2) of the TIL Act.

Ralph I. Rohner and Fred H. Miller, *Truth in Lending* 871 (Robert A. Cook, et al. eds., 2d ed. 2000). As a substantive right under TILA, class actions must be available to consumers either in the judicial or arbitral forum.[53]

The TILA class action right is threatened by the interpretation of federal courts that have held that class arbitration may proceed only if specifically authorized by the agreement or its applicable rules.[54] Even when the agreement is silent on the issue, like the Green Tree agreement, federal courts have enforced the agreement but disallowed class arbitration[55] notwithstanding that enforcement may result in nullifying important statutory rights.[56] Failing to heed the

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[53] *Gilmer* is distinguishable because, unlike TILA, the ADEA imposes barriers to class actions. The ADEA allows only opt-in class actions preceded by 60-day notice to the EEOC. The EEOC then "shall promptly seek ... informal methods of conciliation, conference, and persuasion" and EEOC commencement of an action terminates the private class action. 29 U.S.C. §§ 626(b), (c), (d).

[54] *See Baesler v. Continental Grain Co.*, 900 F.2d 1193,1195 (8th Cir. 1990); *Protective Life Ins. Corp. v. Lincoln Nat'l Life Ins. Corp.*, 873 F.2d 281, 282 (11th Cir. 1989) (*per curiam*); *Del E. Webb Constr. v. Richardson Hosp. Auth.*, 823 F.2d 145, 150 (5th Cir. 1987); *Weyerhaeuser Co. v. Western Seas Shipping Co.*, 743 F.2d 635, 637 (9th Cir. 1984).

[55] *See Champ v. Siegel Trading Co.*, 55 F.3d 269, 275 (7th Cir. 1995); *American Centennial Ins. Co. v. National Cas. Co.*, 951 F.2d 107, 108 (6th Cir. 1991).

[56] *See, e.g., McCarthy v. Providential Corp.*, No. C-94-0627 FMS, 1994 WL 387852 (N.D. Cal. July 19, 1994); *Gammaro v. Thorp Consumer*

(continued...)

Court's warning that parties to an arbitration agreement should not be forced to forgo substantive statutory rights and that "all statutory claims may not be appropriate for arbitration," *Gilmer*, 500 U.S. at 26, many courts have misconstrued the liberal federal policy favoring enforcement of arbitration agreements

Only a few federal courts, including the Eleventh Circuit in *Randolph*, have taken care to balance the federal policy favoring arbitration while upholding statutory integrity. In *Johnson v. Tele-Cash, Inc.*, 82 F. Supp. 2d 264 (D. Del. 1999), a putative class action alleging the failure to disclose excessively high interest rates, the court carefully reviewed TILA's legislative history and damages provisions when considering the enforceability of an arbitration agreement that prohibited class action relief. While mindful of the liberal policy favoring enforcement of arbitration agreements, the court appropriately found that the agreement "would contravene the express congressional intent to 'encourage the use of class actions as an important tool for enforcing Truth in Lending.'" *Id.* at 267, *quoting Bantolina v. Aloha Motors, Inc.*, 419 F. Supp. 1116, 1120 (D. Haw. 1976). Without class relief, TILA would be stripped of its "sting" and reduced to nothing more than a mere nuisance to creditors, thus diminishing the Act's deterrent and remedial functions. *See Johnson*, 82 F.2d at 270.

The reluctance of many federal courts to recognize the key role of class actions in vindicating important statutory rights that affect the public interest will have a devastating effect upon consumers.[57] If consumers are forced into the arbitral forum

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[56] (...continued)
Discount Co., 828 F. Supp. 673, 674 (D. Minn. 1993).

[57] Unlike some federal courts, many state courts have found that class action arbitration is allowed under the FAA. *See, e.g., Keating v. Superior Court*, 645 P.2d 1192, 1209 (Cal. 1982), *rev'd sub nom. on other grounds, Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Blue Cross v. Superior Court*, 78 Cal. Rptr. 2d 779, 790 (Ct. App. 1998), *cert. denied*, 527 U.S.
(continued...)

without the right to seek class-wide relief, creditors will be able to avoid TILA compliance with impunity.[58/]

1. Arbitration Is Not Suitable for Class-wide Adjudication.

Class-wide adjudication is not suitable for arbitration as long as the due process rights of absent class members are not protected. Unless arbitrators guarantee these rights and follow Fed. R. Civ. P. 23, claims under TILA and other statutes imbued with a public purpose cannot, consistent with the Constitution and Congressional intent, be forced into arbitration.

The representative nature of class actions creates particular due process concerns. Special steps must be taken to protect the interests of individuals who will be bound by the outcome of a suit to which they were not a party. These steps include notice, an opportunity to opt out, and assurance that the named plaintiff(s) adequately represent the interests of absent class members at all stages of the litigation. *See, e.g., Ortiz v. Fibreboard Corp.*, 527 U.S. 817, 846 (1999); *Phillips Petroleum v. Shutts Co.*, 472 U.S. 797, 811-12 (1985); *Eisen*, 417 U.S. at 173-74. Unless arbitrators can fulfill this role, class actions cannot be forced into arbitration.

[57/] (...continued)
1003 (1999); *Izzi v. Mesquite Country Club*, 231 Cal. Rptr. 315, 320-22 (Ct. App. 1986); *Dickler v. Shearson Lehman Hutton, Inc.*, 596 A.2d 860, 867 (Pa. Super. Ct. 1991).

[58/] *See In re Knepp*, 229 B.R. 821, 842 (Bankr. N.D. Ala. 1999) ("The pervasive use of arbitration agreements in consumer contracts could have the effect of eliminating class actions. If class actions are no longer an option, the vast majority of consumer claims involving relatively small sums of money on an individual basis will be left without a remedy.").

2. The Demise of Class Actions Would Create a Void In TILA Enforcement.

Petitioners' *amici* have asserted that regulatory enforcement of TILA eliminates the need for class actions. *See, e.g.*, Brief of the Chamber of Commerce of the U.S. at 18-19. These assurances simply do not ring true. The Federal Trade Commission ("FTC"), which has primary enforcement authority over many thousands of consumer finance companies,[59] such as Green Tree, has had few resources allocated for enforcement. As a result, its Division of Financial Practices was able to bring only twenty eight TILA cases between January 1998 and December 1999.[60]

The suggestion that the regulatory agencies are covering the field in enforcing TILA is contradicted by industry testimony before Congress. "First and foremost, these laws, and related regulations, need to be enforced more vigorously. Most abuses could be handled quite effectively by better enforcement."[61] Indeed, the one recommendation on which all industry representatives agreed was that greatly enhanced enforcement is needed, not new legislation.[62] In the face of this testimony,

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[59] 15 U.S.C. §§ 45(a), 1607.

[60] *See* App. 1: Jan. 15, 1999 and Jan. 6, 2000 letters from the Chairman of the FTC to the Director of the Federal Reserve Board's Division of Consumer and Community Affairs (signatures on originals).

[61] *Predatory Lending Practices in the Subprime Industry: Hearings before the House Comm. on Banking and Fin. Servs.* (May 24, 2000) [hereinafter *Predatory Lending Practices*] (testimony of Laura Borelli, Nat'l Home Equity Ass'n).

[62] *Predatory Lending Practices*, *supra* (testimony of Ralph Rohner, Consumer Bankers Ass'n; David Bochnowski, America's Community Bankers; Neill Fendly, National Ass'n of Mortgage Brokers).

the contention of *amici* that class actions are no longer necessary cannot be taken seriously.[63]

C. Unwritten Arbitration Decisions Undermine TILA Enforcement.

TILA cases are intended to protect the public at large, focusing primarily on interpreting the Act and regulations, and only secondarily on the facts.[64] When, however, arbitration is conducted in private and written decisions are not required, it is difficult, if not impossible, to determine whether an aggrieved party's substantive rights have been upheld in the arbitral forum.[65]

"[P]ublished [TILA] case law is necessary to provide guidance to banks," and private, unpublished decisions "eliminate[ ] that source of guidance." Budnitz, *supra*, at 326.[66] The public resolution of cases involving laws that uphold the public's interest help to guide our society.[67] "[W]ritten opinions . . . apply necessarily vague positive law to concrete fact situations." Brunet, *supra*, at 20. The development of law "has a significant purpose to 'channel

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[63] State attorneys general enforcement authority under TILA is limited to redressing violations in connection with "high cost" mortgage loans. *See* 15 U.S.C. § 1640(e).

[64] *See* Mark E. Budnitz, *Arbitration of Disputes Between Consumers and Financial Institutions: A Serious Threat to Consumer Protection*, Ohio St. J. on Disp. Resol. 267, 325 (1995). *Cf.* Stewart E. Sterk, *Enforceability of Agreements to Arbitrate: An Examination of the Public Policy Defense*, 2 Cardozo L. Rev. 481, 492 (1981).

[65] *See* Budnitz, *supra*, at 319.

[66] *See also* Edward Brunet, *Questioning the Quality of Alternative Dispute Resolution*, 62 Tul. L. Rev. 1, 17 (1987).

[67] *See* Brunet, *supra*, at 20.

behavior in such manner as to prevent or avoid conflict.'" *Id.* (citation omitted).

In *Gilmer*, the Court was not confronted with an arbitral forum that failed to provide written public decisions. 500 U.S. at 31-32. Unlike the Green Tree arbitration agreement, the *Gilmer* arbitration was to be conducted pursuant to the NYSE rules requiring that all arbitration awards be in writing, contain sufficient information describing the nature and resolution of the case, and be made public. *Id.* Moreover, the Court found that "judicial decisions addressing ADEA claims will continue to be issued because it is unlikely that all or even most ADEA claimants will be subject to arbitration agreements." *Id.* at 32.

Gilmer stands in sharp contrast to the present case where pre-dispute arbitration clauses have become commonplace in consumer transactions. "It is anticipated that virtually all major banks and lending institutions will implement consumer arbitration procedures within the next five years."[68] As a result, consumers are no longer able to avoid arbitration by taking their business elsewhere.[69]

The widespread use of consumer arbitration agreements could remove the judiciary's influence from entire industries or economic relationships.[70] The courts have been instrumental

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[68] Alan S. Kaplinsky & Mark J. Levin, *Excuse me, but who's the predator? Banks can use arbitration clauses as a defense*, 7 Bus. L. Today 24, 28 (May/June 1998).

[69] Senator Feingold stated that "consumer credit lenders are increasingly requiring their customers to use binding arbitration when a dispute arises. . . . [T]he practice is becoming so pervasive that consumers may soon no longer have an alternative, unless they forego use of a credit card or a consumer loan entirely." 146 Cong. Rec. S930, 933-34 (daily ed. Feb. 29, 2000) (statement of Sen. Feingold).

[70] David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled*

(continued...)

in defining TILA provisions that serve to protect consumers and guide creditors. If the development of TILA law ceases, the purpose of TILA to provide uniform rules may also cease.

> A statute is a legislative policy choice, but without subsequent judicial development through the public resolution of disputes, that policy will remain stagnant, or perhaps wither entirely. . . . Even if initial principles are established through adjudication, permitting the arbitration of an entire category of claims restricts further evolution in that area of the law by reducing the number and variety of claims presented to the courts.

John V. O'Hara, *The New Jersey Alternative Procedure For Dispute Resolution Act: Vanguard of a 'Better Way'?*, 136 U. Pa. L. Rev. 1723, 1746 (1988). Indeed, arbitration resolution, without written public decisions, undermines the principle of *stare decisis*, which preserves our body of law. *Stare decisis* "promotes evenhanded, predictable and consistent development of legal principles . . . and contributes to the actual and perceived integrity of the judicial process." *Payne v. Tennessee*, 501 U.S. 808, 827 (1991); *see also Planned Parenthood v. Casey*, 505 U.S. 833, 854 (1992). As Justice Powell noted, "*[S]tare decisis* is necessary to have a predictable set of rules on which citizens may rely in shaping their behavior." Justice Lewis F. Powell, *Stare Decisis and Judicial Restraint*, 47 Wash. & Lee L. Rev. 281, 286 (1990).

In order to preserve the public policy foundation of TILA and provide compliance guidance for creditors, arbitrators resolving cases must apply the statutory law and issue written opinions that are publicly available.

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[20] (...continued)
Arbitration, 1997 Wis. L. Rev. 33, 59 (1997).

D. Green Tree's Arbitration Clause is Typical of Those Designed to Prevent Consumers From Acting as Private Attorneys General Under TILA.

The current trend of lenders and other businesses to impose binding arbitration on their customers in order to prevent litigation is indisputable.

> Consumers have been ganging up on banks. But now the institutions have found a way to defend themselves. . . . Arbitration is a powerful deterrent to class action lawsuits against lenders because the great weight of authority holds that arbitrations cannot be conducted on a class basis unless the parties have agreed to do so. . . . Lenders that have not yet implemented arbitration programs should promptly consider doing so, since each day that passes brings with it the risk of additional multimillion-dollar class action lawsuits that might have been avoided had arbitration procedures been in place.

Kaplinsky & Levin, *supra*, at 24-26, 28.

Green Tree's success in adopting this approach to avoid legal consequences for its lending practices cannot be overlooked. Arbitration agreements have enabled Green Tree to avoid scrutiny of its alleged widespread deceptive practices in the financing of home improvement contracts and mobile home sales throughout the nation.[7]/ Having successfully forced many lawsuits into the arbitral forum, Green Tree is now actively seeking to deprive claimants of their substantive right to pursue these claims as class actions. Green Tree has

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[7]/ *See, e.g., Harris v. Green Tree Fin. Corp.*, 183 F.3d 173 (3d Cir. 1999) (home improvement); *Pridgen v. Green Tree Fin. Servicing Corp.*, 88 F. Supp. 2d 655 (S.D. Miss. 2000) (mobile home); *Green Tree Fin. Corp. v. Holt*, 171 F.R.D. 313 (N.D. Ala. 1997) (class mobile home); *Lackey v. Green Tree Fin. Corp.*, 498 S.E.2d 898 (S.C. Ct. App. 1998) (class mobile home).

vigorously opposed the prosecution of these claims through class arbitration.[22]

Green Tree's use of the arbitral forum to compel consumers to "forego the substantive rights afforded by the statute" is in direct conflict with the Court's decisions in *Mitsubsishi*, 473 U.S. at 628, and *Gilmer*, 500 U.S. at 26. Green Tree's improper use of arbitration undermines the very essence of TILA's private attorney general scheme. Green Tree has, in effect, bypassed the legislative and judicial processes to alter the legal system to meet its own goals and to protect its "bottom line" regardless of – or precisely because of – the merits of numerous customers' claims. This behavior must not be countenanced by the Court.

CONCLUSION

Consumers' statutory rights under TILA cannot be defeated through the mechanism of the arbitral forum. Consumers who are required to pursue their TILA claims in arbitration must be accorded their full rights and remedies under the statute, including fee-shifting and the pursuit of class claims, and protection of their due process rights in class arbitrations. As long as these rights, remedies, and protections are not afforded

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[22] Subsequent to the Third Circuit's decision in *Harris*, 183 F.3d 173 (3d Cir. 1999), Green Tree has opposed allowing these arbitrations to proceed on a class-wide basis. There are no citations to these proceedings because arbitration is not public. *See also Lackey v. Green Tree Fin. Corp.*, 498 S.E.2d 898 (S.C. Ct. App. 1998) (a class action proceeded to class arbitration over Green Tree's objection). *See* App. 2: Green Tree's Mem. Opp. to Class Arbitration (signature on originals).

under arbitration agreements, consumers must be permitted their day in court.

July 24, 2000

Respectfully submitted,

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APPENDIX 1

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

Office of the Chairman

January 15, 1999

Dolores S. Smith, Director
Division of Consumer and Community Affairs
Board of Governors of the Federal Reserve System
Washington, D.C. 20551

Dear Ms. Smith:

This letter responds to your request for information regarding the enforcement activities of the Federal Trade Commission under the Truth in Lending, Consumer Leasing, Equal Credit Opportunity, and Electronic Fund Transfer Acts ("Acts") during the past year for use in preparing the Federal Reserve Board's ("Board") Annual Report to Congress. You have asked for information regarding the Commission's enforcement activities pursuant to those Acts, including methods of enforcement and significant enforcement actions and the extent to which compliance is achieved by entities subject to the Commission's enforcement authority. Also, you have asked whether the Commission recommends any changes to these laws or their implementing regulations or wishes to provide any other comments or observations.

I. A DESCRIPTION OF THE COMMISSION'S ENFORCEMENT ACTIVITIES UNDER THE ACTS DURING THE PAST YEAR

Truth in Lending Act and Consumer Leasing Act

Since January 1998 up to the present, the Commission filed a complaint in federal district court charging a Washington, D.C. mortgage lender and its owner, inter alia, with violating the Truth In Lending Act ("TILA") and Regulation Z and the Federal Trade Commission Act ("FTC Act"), in connection with alleged deceptive and unfair practices in home mortgage lending. The Commission also issued final decisions and orders in thirteen administrative cases concerning alleged deceptive lease and/or credit advertising in violation of the FTC Act, and failure to clearly and conspicuously disclose and/or failure to make available advertised lease and/or credit terms, in violation of the Consumer Leasing Act ("CLA") and Regulation M and/or the TILA and Regulation Z. The above cases are discussed below. Other investigations of possible TILA and/or CLA violations are ongoing.

In Federal Trade Commission v. Capital City Mortgage Corp. ("Capital City Mortgage"),[1/] the Commission filed a complaint in United States District Court for the District of Columbia against a Washington, D.C. area mortgage company and its owner, Thomas K. Nash, alleging numerous violations of federal laws, inter alia, the TILA and

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[1/] No. 98CV00237 (D.D.C. filed Jan. 29, 1998).

Regulation Z and the FTC Act.[2/] The complaint alleges that defendants' borrowers, in many instances, are minority and/or elderly persons living on fixed or low incomes and that defendants' loans include interest rates that generally ranged between 20-24 percent, for loans secured by home equity, and 9-12 percent, for purchase money loans. According to the complaint, in many instances, defendants' transactions involve interest-only balloon, rather than amortizing, loans. The complaint alleges, inter alia, that defendants, in many instances, violated the TILA and Regulation Z, and engaged in unfair or deceptive acts or practices in violation of the FTC Act, by: 1) understating the annual percentage rate and finance charge; 2) overstating the amount financed; 3) failing to disclose or accurately disclose the payment schedule or the total of payments (including but not limited to failing to disclose a balloon payment); 4) failing to provide disclosures before consummating the transaction and in the required format; 5) failing to provide disclosures that accurately reflect the legal obligation; and 6) failing to provide or correct certain "good faith"disclosures.

The complaint also alleges that defendants engaged in other deceptive or unfair practices in offering and extending credit and throughout the duration of the loans, in violation of the FTC Act, with the result that a number of borrowers were overcharged on their loans, were defaulted, and had title to their homes or other property impaired or completely lost (along with the equity). These alleged deceptive or unfair practices include: 1) representing a loan as an amortizing

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[2/] The complaint in this matter also alleges, inter alia, violations of the Equal Credit Opportunity Act. See infra p. 7.

loan when, in fact, it was an interest-only balloon loan; 2) representing that loan payments were higher than they should have been under the loan instruments by demanding that borrowers pay for services not provided, for charges imposed by the government or related entities on defendants prior to the borrowers' purchase of the property, and for no-insurance penalties when defendants were to provide the insurance or the borrower had timely purchased insurance; 3) collecting real estate tax escrow payments, failing to pay the taxes and representing that the taxes had been paid; 4) refusing to explain overcharges; 5) initiating foreclosure proceedings after nonpayment of overcharges and obtaining title by foreclosure or taking a deed in lieu thereof; 6) adding charges to arrears or loan principal and accruing compound interest and increasing the pay-off amount; 7) receiving sufficient pay-off amounts but refusing to release the lien without further payment; and 8) refusing to reinstate a borrower after the borrower paid the reinstatement fee.

The complaint asks the court to award, inter alia, the amount necessary to prevent unjust enrichment and consumer redress (including refunds of monies paid, disgorgement of ill-gotten gains, and rescission of contracts) and to permanently restrain defendants from future law violations. The case is now in the discovery phase; a trial date has not yet been set.[3/]

[3/] The case has been joined, for purposes of discovery, with a private lawsuit, Hargraves v. Capital City Mortgage Corp., No. 98CV1021 (D.D.C. filed Apr. 24, 1998).

In Chrysler Corporation, Inc. ("Chrysler"),[4] Bozell Worldwide, Inc. ("Bozell"),[5] and Martin Advertising, Inc. ("Martin"),[6] the Commission issued final decisions and orders in three cases involving alleged deceptive lease and/or credit advertising in the automobile industry, in violation of the CLA and Regulation M and/or the TILA and Regulation M and the FTC Act. The complaints charged that Chrysler and Bozell, its national advertising agency, and Martin, a regional advertising agency for General Motors's dealerships and dealer associations, created and disseminated deceptive lease and/or credit advertisements that promoted various terms (including monthly payment amounts) and omitted key cost terms or buried this information in fine, and at times unreadable, print, in violation of the CLA and Regulation M and the FTC Act. Chrysler and Bozell also were charged with misrepresenting that the luxury vehicle model displayed in ads was available at the prominent, low lease terms, in violation of the FTC Act. In fact, according to the complaint, the low monthly payments applied to Chrysler models of lesser value than those featured in the ads, and information about lease inception fees and other terms appeared only in unreadable fine print and was not clear and conspicuous, in violation of the CLA and Regulation M and the FTC Act.

The complaint against Martin also alleges that the company violated the FTC Act, the CLA and Regulation M, and the TILA and Regulation Z regarding its automobile lease and credit advertising. The complaint charges that Martin's

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[4] FTC Docket No. C-3847 (Jan. 13, 1999).

[5] FTC Docket No. C-3845 (Jan. 13, 1999).

[6] FTC Docket No. C-3846 (Jan. 13, 1999).

television and radio lease ads were deceptive by: 1) misrepresenting that consumers could purchase a vehicle by paying low monthly payments, when, in fact, the offers involved leases and the ads omitted this fact or hid the information in fine print or rapidly-stated audio disclosures; 2) misrepresenting the amount consumers were required to pay at lease inception; and 3) omitting or hiding important information about lease inception fees in unreadable fine print or incomprehensible audio disclosures. The complaint also alleges that Martin's balloon payment credit ads were deceptive and falsely represented that consumers could buy a car by making only low monthly payments, inadequately disclosing the existence and amount of a final balloon payment, a substantial down payment, the annual percentage rate, or other terms of repayment. The complaint further alleges that Martin's lease and credit ads violated the CLA and Regulation M and TILA and Regulation Z by omitting required disclosures or making disclosures that were not clear and conspicuous and by failing to state a rate of finance charge as an annual percentage rate or "APR."

The orders with Chrysler, Bozell, and Martin prohibit misrepresentations of the total amount due at lease signing or delivery, the amount down and/or down payment, and the capitalized cost reduction or other amount that reduces the capitalized cost of the vehicle (or that no such amount is required). The orders also prohibit the companies from stating any charge that is part of the total due at lease signing or delivery, or that no such charge is required (other than a statement of the periodic payment) more prominently than a statement of the total amount due at lease signing or delivery. The orders also prohibit the companies from stating the amount of any payment unless the ad also states, clearly and conspicuously, all of the terms required by the CLA and

Regulation M. In addition, the orders in Chrysler and Bozell prohibit these companies from misrepresenting the vehicle model available to consumers in connection with any advertised lease offer. In Martin, the order also prohibits the company from misrepresenting that any motor vehicle lease advertisement pertains to a cash or credit offer. This order also prohibits the company from misrepresenting the existence and amount of any balloon payment or the annual percentage rate. In addition, the order prohibits Martin from stating the monthly payment or other credit terms without, clearly and conspicuously, stating all of the terms required by the TILA and Regulation Z. Under all three orders, the disclosures required by the CLA or TILA for lease and/or credit advertising must be made "clearly and conspicuously"-- that is, in a manner that is readable (or audible) and understandable to a reasonable consumer.

In Grey Advertising, Inc. ("Grey"),[7/] Rubin Postaer and Associates, Inc. ("Rubin Postaer"),[8/] and Foote, Cone and Belding, Inc. ("FCB"),[9/] the Commission issued final decisions and orders with three national advertising agencies resolving charges that they violated the CLA and Regulation M and/or the TILA and Regulation Z and the FTC Act by misrepresenting, hiding, and failing to disclose adequately the true terms of their advertised automobile lease and credit deals. The orders settled charges that these companies developed and disseminated deceptive advertisements for "zero down," "penny down," or other low amounts due at

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[7/] FTC Docket No. 3793 (Apr. 6, 1998).

[8/] FTC Docket No. 3794 (Apr. 6, 1998).

[9/] FTC Docket No. 3792 (Apr. 6, 1998).

inception in lease advertisements for Mitsubishi Motor Sales of America, Inc., American Honda Motor Corporation, and Mazda Motor of America, Inc., respectively. In Grey, Rubin Postaer, and FCB, the Commission alleged that the lease ads misrepresented the true amounts that consumers were required to pay at inception and did not adequately provide material cost information necessary to prevent misleading consumers who had to pay significant fees. According to the allegations, the ads presented information about these additional fees only in unreadable print that appeared: 1) in type too small; 2) for too short a duration; 3) in quick "scrolling"text; 4) against moving or distracting backgrounds; and/or 5) in a location far removed from the more prominent representations. The complaint against Grey also alleged that this company created and disseminated deceptive automobile balloon payment credit advertisements. The Commission alleged that these credit ads misrepresented that consumers could buy a car by making low monthly payments and paying low amounts "down" and did not adequately disclose the existence and amount of a several thousand dollar final balloon payment, the APR, and other terms of repayment. Instead, as alleged, the credit ads placed this critical cost information in unreadable fine print disclosures.

Under all three final orders, the companies may not, inter alia, misrepresent in any motor vehicle lease advertisement the total amount due at lease signing or delivery, the amount down, and/or the down payment, the capitalized cost reduction, or any other amount that reduces the capitalized cost of the vehicle (or that no such amount is required). Also, any ad that highlights an amount "down" or mentions certain other amounts due at lease inception (or states that there is no such charge) would have to provide an equally prominent statement of the total amount due at lease

inception. The final order with Grey also, among other things, prohibits the company in any closed-end credit advertisement involving motor vehicles from misrepresenting the existence and amount of any balloon payment or the annual percentage rate.

In Toyota Motor Sales, U.S.A., Inc. ("Toyota"),[10/] Volkswagen of America, Inc. ("Volkswagen),[11/] Suntrup Ford., Inc. and Suntrup Buick-Pontiac-GMC Truck, Inc. ("Suntrup"),[12/] Lou Fusz Automotive Network, Inc. ("Lou Fusz"),[13/] Beuckman Ford, Inc. ("Beuckman"),[14/] and Frank Bommarito Oldsmobile, Inc. ("Bommarito"),[15/] the

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[10/] FTC Docket No. C-3776 (Jan. 5, 1998).

[11/] FTC Docket No. C-3778 (Jan. 5, 1998).

[12/] FTC Docket No. C-3779 (Jan. 5, 1998). As indicated above, the final decision and order covered two related companies: Suntrup Ford, Inc. and Suntrup Buick-Pontiac-GMC- Truck, Inc. A separate consent agreement was signed by each company, however. See Suntrup Ford, Inc., FTC File No. 952 3200 (Oct. 7, 1997), and Suntrup Buick-Pontiac-GMC Truck, Inc., FTC File No. 952 3201 (Oct. 7, 1997).

[13/] FTC Docket No. C-3780 (Jan. 5, 1998).

[14/] FTC Docket No. C-3777 (Jan. 5, 1998).

[15/] FTC Docket No. C-3774 (Jan. 5, 1998).

Commission issued final decisions and orders with two major automobile manufacturers and five St. Louis, Missouri-area dealerships and their Chief Executive Officers ("CEOs") pertaining to deceptive lease and/or credit advertisements. As reported on last year when the orders were accepted for public comment, these orders settled charges that the seven companies violated the CLA and Regulation M and/or the TILA and Regulation Z and the FTC Act by misrepresenting, hiding, or failing to adequately disclose the cost and terms of automobile lease and/or credit transactions. The orders in Toyota and Volkswagen prohibit misrepresentations of the total amount due at lease signing and require lease ads that state any charge that is part of the amount due at lease signing or that no such charge is required (excluding a statement of the periodic payment) to state with equal prominence the total amount due at lease signing. These manufacturers are also required to comply with all requirements of the CLA and Regulation M in lease ads. The orders in the St. Louis cases prohibit the dealerships and their CEOs from misrepresenting the costs of leasing, including the total amount due at lease signing. The orders also require compliance with all aspects of the CLA and Regulation M, including that mandatory triggered terms in advertisements be stated clearly and conspicuously. Also, the Lou Fusz order prohibits misrepresentations of the type of transaction advertised, including that the offer is for a one- payment lease. It enjoins Lou Fusz from advertising that a specific offer is available, unless the company usually and customarily offers to lease vehicles at the advertised terms. The Beuckman order would also prevent the company from stating the term "RCL" without stating clearly and conspicuously that this term refers to a lease. The Bommarito order also prohibits misrepresentations of the terms of financing a vehicle, including the amount of any balloon payment. In addition,

Bommarito is required to include the amount of any final balloon payment prominently, and in close proximity, to certain advertised credit terms. The orders with the St. Louis dealerships also prohibit violations of the TILA and Regulation Z.

The Commission continues to view consumer and business education efforts as important to its enforcement activities. In 1998, in view of increasing issues concerning possible home equity fraud, the Commission issued three consumer publications to provide additional information to consumers considering home equity loans and reverse mortgages: "Home Equity Loans: The Three-Day Cancellation Rule;" "Reverse Mortgages -- Cashing in on Home Ownership;" and "Home Equity Scams: Borrowers Beware."[16/] The Commission also issued a news release, "Northwest, Air Canada Airlines Customers with Canceled Tickets May Have Rights under Federal Credit Law," to assist consumers in using their rights under the Fair Credit Billing Act, an amendment to the TILA. The Commission staff also continued to participate in the Board-sponsored "Leasing Education Program Team," involving the Board, Commission staff, and a coalition of entities (including consumer groups, state attorneys general and industry representatives) now developing online and other forms of lease materials to enhance awareness and understanding of

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[16/] " These publications were also designed to assist consumers in Texas, where the state constitution was amended to allow companies to offer general home equity loans, starting in 1998, for the first time in that state's history. See, e.g., "FTC Release: FTC Education Effort Focuses on Home Equity Loan Fraud" (May 20, 1998).

leasing. All of the above consumer protection and business education materials were also made available to the public through the Commission's Website at "www.ftc.gov. "[17/]

Equal Credit Opportunity Act

In 1998, the Commission filed a complaint in federal district court charging a Washington, D.C. area mortgage lender with, inter alia, violations of the Equal Credit Opportunity Act ("ECOA") and Regulation B and the FTC Act. This case is discussed below. Other enforcement efforts continue.

In January 1998, the Commission filed a complaint in United States District Court for the District of Columbia in Capital City Mortgage,[18/] alleging that this company and its owner, Thomas K. Nash, violated the ECOA and Regulation B and engaged in unfair or deceptive acts or practices in violation of the FTC Act, in numerous manners. These alleged ECOA violations included: 1) failing to take written applications for mortgage loans; 2) failing to collect required information about the race or national origin, sex, marital status, and age of applicants; 3) failing to provide applicants with written notice of adverse action; and 4) providing notice of adverse action, but failing to provide applicants with: a) the correct principal reason for the action taken or b) the correct name and address of the Federal Trade Commission, the

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[17/] " Information regarding the Commission's enforcement actions and other activities discussed in this report are also available at this Website.

[18/] See supra note 1.

federal agency that administers compliance with the ECOA with respect to Capital City and Nash. As indicated above, this case is now in the discovery phase, and it has been joined for discovery purposes with a private lawsuit.[19/] The Commission is seeking civil penalties and injunctive relief for the alleged violations of the ECOA and Regulation B and the FTC Act.

In May 1998, the Commission and other federal agencies submitted a joint comment to the Board about Regulation B.[20/] The comment was submitted in response to the Board's request for comment and advance notice of proposed rulemaking. In their comment, the agencies urged the Board to amend Regulation B to permit lenders voluntarily to collect information about the race and gender of applicants for non-mortgage credit. According to the comments, the current prohibition of collecting such information "needlessly inhibits the ability of financial service providers to learn about and respond to market opportunities to better serve underserved communities. The prohibition makes it difficult for institutions to know whether products intended to expand access to credit, including to minorities, reach their intended customer base."

[19/] See supra note 3.

[20/] Letter from Commission, Department of Treasury, Department of Justice, Department of Housing and Urban Development, Office of the Comptroller of the Currency, Office of Thrift Supervision, and Small Business Administration to William W. Wiles, Secretary, Board of Governors of the Federal Reserve System dated May 28, 1998.

The comments also urged the Board to clarify that creditors may not discriminate on a prohibited basis in their preapplication marketing practices.[21/]

The Commission continued its consumer and business education efforts in this area. In September 1998, Commissioner Thompson and Consumer Protection Bureau Director Bernstein participated in credit-related seminars as part of the Congressional Black Caucus Foundation's Legislative Weekend.[22/] Among other things, at this conference, a new FTC credit publication was released. The publication, "Bound for Good Credit," combines in one source for consumers many of the agency's most popular credit brochures (including information about the ECOA).

The Commission staff also worked with other governmental agencies and with creditor and consumer organizations to increase awareness of and compliance with the ECOA. The Commission staff also continued to participate actively in the Interagency Task Force on Fair Lending.

[21/] The Commission voted 3-1 to file this comment with the Board, with Commissioner Azcuenaga not participating and Commissioner Swindle dissenting and issuing a statement concurring in part and dissenting in part.

[22/] See "FTC Release: FTC Officials Discuss Consumer Credit Issues and Highlight Consumer Education Efforts" (Sept. 18, 1998).

Electronic Fund Transfer Act

In March 1998, in the America Online, Inc. ("AOL"),[23] CompuServe, Inc. ("CompuServe"),[24] and Prodigy Services Corporation ("Prodigy"),[25] the Commission issued final decisions and orders in three cases alleging violations of the FTC Act and the Electronic Fund Transfer Act ("EFTA") and Regulation E. These cases resolved Commission charges that the companies' "free trial" offers resulted in unexpected charges for many consumers. As reported on last year when the orders were accepted for public comment, the complaints alleged that these Internet service providers failed to make clear that consumers had an affirmative obligation to cancel before the trial period ended. As a result, consumers who failed to cancel were automatically enrolled as members and began incurring monthly charges. The settlements, inter alia, prohibit AOL, CompuServe and Prodigy from: misrepresenting the terms or conditions of any online service trial offer; and representing that an online service is free or otherwise representing that consumers need not pay for the online service, unless they disclose clearly and prominently in their instructional materials any obligation to cancel or take other action to avoid charges, and in all other advertisements include a statement directing consumers to where this disclosure is available. The

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[23] FTC Docket No. C-3787 (Mar. 24, 1998).

[24] FTC Docket No. C-3789 (Mar. 24, 1998).

[25] FTC Docket No. C-3788 (Mar. 24, 1998).

AOL settlement also requires the company to disclose the manner in which fees or charges are assessed or calculated and bars misrepresentations about the terms or conditions of any electronic fund transfer from a consumer account.

II. AN ASSESSMENT OF THE EXTENT TO WHICH COMPLIANCE IS BEING ACHIEVED BY CREDITORS SUBJECT TO THE COMMISSION'S ENFORCEMENT AUTHORITY[26/]

Truth in Lending Act and Consumer Leasing Act

This year, the Commission received various inquiries regarding home equity lending, including, for example, those concerning credit insurance and loan "flipping." Many mortgage brokers requested information about the disclosure requirements of Regulation Z, including copies of the regulation and the Board's Official Staff Commentary. Many businesses continued to request information about the lease advertising requirements of Regulation M, including copies of the Commission's brochure, "Advertising Consumer Leases." Some consumers requested information about lease transactions, including copies of the FRB-FTC Lease

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[26/] Among other things, the Commission is charged with enforcement of the FTC Act and various federal consumer credit laws and regulations, including the TILA, ECOA and EFTA, with respect to most nonbank entities in the nation. It does not have data regarding the extent of compliance by these numerous entities with these requirements. In lieu thereof, the Commission is providing information regarding certain issues raised by consumers and/or business entities pertaining to these mandates.

Education Program Team's "Keys to Vehicle Leasing."

Equal Credit Opportunity Act

The Commission received some inquiries about fair lending matters. The Commission continued to receive requests for information about ECOA requirements from mortgage lenders and mortgage brokers.

Electronic Fund Transfer Act

The Commission received some inquiries from consumers regarding EFTA protections for point-of-sale debit transactions, including those regarding unauthorized transactions and error resolution procedures. The Commission receives a small number of inquiries about these rules in comparison to those under the credit and lease requirements.

III. ANY SUGGESTIONS FOR CHANGES IN THE ACTS OR THEIR IMPLEMENTING REGULATIONS

The Commission supports the Board's regulatory review, now under way, of Regulation B. The Commission also understands that the Board expects to undertake a review of Regulation Z, after conclusion of its Regulation B review. Because Regulation Z affects many diverse types of transactions and issues, the Commission would support any such effort to update and clarify these requirements as well.

The Commission hopes that the information contained in this letter responds to your inquiry and will assist in preparation of the Board's Annual Report to

Congress. If any other information would be useful or if you request additional assistance, please contact David Medine, Associate Director, Division of Financial Practices, at (202) 326-3025.

By direction of the Commission.

Robert Pitofsky
Chairman

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

January 6, 2000

Dolores S. Smith, Director
Division of Consumer and Community Affairs
Board of Governors of the Federal Reserve System
Washington, D.C. 20551

Dear Ms. Smith:

This letter responds to your request for information regarding the enforcement activities of the Federal Trade Commission ("Commission" or "FTC") under the Truth in Lending, Consumer Leasing, Equal Credit Opportunity, and Electronic Fund Transfer Acts ("Acts") during the past year for use in preparing the Federal Reserve Board's ("Board") Annual Report to Congress. You have asked for information regarding the Commission's enforcement activities pursuant to those Acts, including methods of enforcement and significant enforcement actions and the extent to which compliance is achieved by entities subject to the Commission's enforcement authority. Also, you have asked whether the Commission recommends any changes to these laws or their implementing regulations or wishes to provide any other comments or observations.

I. A DESCRIPTION OF THE COMMISSION'S ENFORCEMENT ACTIVITIES UNDER THE ACTS DURING THE PAST YEAR

Truth in Lending Act and Consumer Leasing Act

Since January 1999 up to the present, the Commission obtained consent judgments against seven subprime mortgage lenders and their owners for alleged violations of the Home Ownership and Equity Protection Act ("HOEPA"),(1) the Truth in Lending Act ("TILA"), Regulation Z, and/or the Federal Trade Commission Act ("FTC Act"). The Commission also issued a final decision and order against a nationwide mortgage company (and its successor entities) in connection with the company's alleged deceptive cost information and deceptive practices, in violation of the TILA and Regulation Z and the FTC Act. Litigation is also continuing in federal district court regarding a complaint charging a Washington, D.C. mortgage lender and its owner, inter alia, with violating the Truth in Lending Act ("TILA") and Regulation Z and the FTC Act, in connection with alleged deceptive and unfair practices in home mortgage lending. The Commission also issued one consent decree against a vehicle manufacturer, and one consent decree against two related vehicle dealerships and their owner, providing for civil penalties and other relief for alleged lease and/or credit advertising violations of defendants' prior FTC orders settling charges that the entities failed to disclose and/or failed to disclose clearly and conspicuously required lease and/or credit advertising cost information, in violation of the Consumer Leasing Act ("CLA") and Regulation M and/or the TILA and Regulation Z and the FTC Act. The Commission also issued two final decisions and orders, and accepted for public comment consent agreements in five other cases, involving

lease and/or credit advertising. These cases alleged deceptive lease and/or credit advertising claims in violation of the FTC Act and failure to disclose and/or failure to disclose clearly and conspicuously important lease and/or credit cost terms, in violation of the CLA and Regulation M and/or the TILA and Regulation Z, in computer leases or vehicle leases. These cases are discussed below. Other investigations of potential TILA and/or CLA violations are ongoing.

A. Mortgage Cases Alleging HOEPA Violations

In 1999, consent judgments were entered in seven cases against subprime mortgage lenders around the country for alleged violations of the HOEPA, TILA and Regulation Z, and the FTC Act:(2) Federal Trade Commission v. Cooper ("Cooper"),(3) Federal Trade Commission v. Capitol Mortgage Corp. ("Capitol Mortgage"),(4) *Federal Trade Commission v. CLS Financial Services, Inc.* ("CLS Financial"),(5) *Federal Trade Commission v. Granite Mortgage, LLC* ("Granite Mortgage"),(6) *Federal Trade Commission v. Interstate Resource Corp.* ("Interstate"),(7) *Federal Trade Commission v. LAP Financial Servs., Inc.* ("LAP Financial"),(8) and *Federal Trade Commission v. Wasatch Credit Corp.* ("Wasatch Credit").(9) These cases were part of the Commission's "Operation Home Inequity," a law enforcement and consumer education campaign seeking to enforce HOEPA and curb abusive practices in subprime mortgage lending. All seven cases involve injunctive relief under HOEPA, the TILA, Regulation Z, and the FTC Act. In six cases, the defendants agreed to pay consumer redress totaling $572,500; in two cases, the companies must obtain performance bonds before they offer or extend specified credit in the future; and, in one case, defendants are banned from any future involvement with high-cost loans

secured by consumers' homes.

In *Cooper*, the complaint alleged that Barry Cooper dba Barry Cooper Properties violated HOEPA, Regulation Z, and the FTC Act by including a prohibited prepayment penalty in its mortgage loans and by engaging in asset-based lending practices. As part of the settlement, Cooper agreed to pay $25,000 in consumer redress. The consent judgment, *inter alia*, also prohibits Cooper from offering or making any HOEPA loan for five years, unless he first obtains a $150,000 performance bond, and requires Cooper to reform consumers' contracts by nullifying the prohibited provisions.

In *Capitol Mortgage*, the complaint alleged that the company and its principal violated HOEPA Regulation Z, and/or the FTC Act by failing to give consumers the required HOEPA notice and disclosure of terms and by improperly depriving consumers of the three-day waiting period created by HOEPA. The complaint also alleged that defendants included prohibited balloon payments, increased interest rate provisions, and prepayment penalties in loan documents. The complaint further alleged that the company violated TILA and Regulation Z, *inter alia,* by failing to make required disclosures and by engaging in practices that deprived consumers of the three-day right to rescind the loan. The consent judgment, *inter alia*, bars defendants from participating in any activity related to certain high-cost loans secured by consumers' principal dwellings and requires defendants to reform existing contracts to nullify prohibited provisions.

In *CLS Financial*, the complaint charged the company and its main principal with violating HOEPA, Regulation Z, and/or the FTC Act by failing to provide required HOEPA notices

and disclosures and by using prohibited balloon payment and interest rate increase provisions. The complaint also charged that the company made loans involving asset-based lending in violation of HOEPA and that defendants allegedly falsely labeled loans as "open-end" credit in an attempt to evade HOEPA, in violation of the FTC Act. The consent judgment, *inter alia*, requires defendants to pay $60,000 in consumer redress and to reform open loans to nullify prohibited provisions.

In *Granite Mortgage*, the complaint alleged that the company, two other entities, and two principals violated HOEPA, Regulation Z, and/or the FTC Act by failing to provide required HOEPA notices and disclosures. The complaint also alleged that defendants violated HOEPA,
Regulation Z, and/or the FTC Act by using prohibited prepayment penalty provisions and engaging in asset-based lending. The complaint also charged the company and other entities with failing to provide required TILA disclosures. The consent judgment, *inter alia*, requires defendants to pay $132,500 in consumer redress and to reform open loans to nullify prohibited provisions.

In *Interstate*, the complaint alleged that the company and two principals violated HOEPA, Regulation Z, and/or the FTC Act by failing to provide material credit information as required by HOEPA. Under the consent judgment, defendants are required, inter alia, to pay $50,000 in consumer redress.

In *LAP Financial*, the complaint charged the company and its principal with numerous violations of HOEPA, Regulation Z, and/or the FTC Act, including failure to provide required HOEPA notices and disclosures; asset-based lending; using

prohibited prepayment penalties; and making direct payments to home improvement contractors. The complaint also alleged that the company violated TILA and Regulation Z by failing to provide required disclosures and engaging in rescission-related violations. The consent judgment, inter alia, requires defendants to pay $250,000 in consumer redress and to reform loans by nullifying prohibited provisions.

In *Wasatch Credit*, the complaint charged Wasatch Credit, related entities, and two principals with violating HOEPA, Regulation Z, and/or the FTC Act by failing to provide HOEPA notices and disclosures and/or by improperly depriving consumers of the three-day HOEPA waiting period. The complaint also alleged that defendants used prohibited balloon payment and increased interest rate provisions and engaged in asset-based lending, in violation of HOEPA, Regulation Z, and/or the FTC Act. It further alleged that defendants violated TILA, Regulation Z, and/or the FTC Act by failing to provide required disclosures and engaging in practices that deprived consumers of their right to rescind the loan. It also alleged that, in violation of the FTC Act, defendants directed borrowers to falsely characterize consumer loans as business loans (in an apparent attempt to evade HOEPA and the TILA) and that one entity falsely represented to consumers that the credit offered and extended was open-end when, in fact, it was closed-end. Under the consent judgment, defendants are required, inter alia, to pay $55,000 in consumer redress and to reform existing contracts to nullify prohibited provisions. Defendants are also prohibited from offering or extending consumer credit, unless they first obtain a $250,000 performance bond that would remain in effect for five years.

B. *Other Mortgage Cases*

In *Fleet Finance, Inc. and Home Equity U.S.A., Inc.* ("Fleet Finance"),(10) the Commission issued a final decision and order settling charges that Fleet Finance violated the TILA and Regulation Z, and engaged in deceptive practices in violation of the FTC Act, by failing to provide accurate, timely disclosures of the costs and terms of home equity loans (and other consumer credit transactions) to consumers and by failing to provide or accurately provide consumers with information about their home equity rescission rights. More specifically, the complaint charged that Fleet Finance extended consumer credit transactions or purchased consumer credit transactions, in which Fleet Finance acquired or retained a security interest in the consumers' principal dwellings, and failed to provide the consumers with the right to rescind the credit transactions by, inter alia: 1) failing to provide consumers with notices of the right to rescind; and 2) waiving consumers' right to rescind, and disbursing funds, pursuant to oral and other insufficient waivers. The complaint also alleged that Fleet Finance in extending consumer credit transactions: 1) failed to provide consumers with all TILA-required disclosures of the costs and terms of credit and/or provide these disclosures prior to consummation of credit transactions; 2) failed to provide or accurately provide certain TILA disclosures, including the annual percentage rate. The complaint also alleged that Fleet Finance purchased consumer credit transactions that failed to provide or accurately provide required TILA disclosures. The complaint also alleged that Fleet Finance failed to retain, inter alia, TILA disclosures and rescission notices for two years, in violation of Regulation Z.

The order requires Fleet Finance and its successor companies,

Home Equity U.S.A. (incorporated in Rhode Island and Delaware), to pay $1.3 million for consumer redress and administrative costs. The redress program applies to certain consumers whose mortgage loans were originated or purchased by Fleet Finance or a predecessor company (also named "Fleet Finance") between January 1, 1990 and December 31, 1993. The program covers certain consumers whose mortgage loans, inter alia, were paid off to or written off by Fleet Finance, the predecessor, or Fleet Financial Group, Inc., a parent corporation. The program also covers certain consumers who contact an 800-number set up under the proposed order and provide information showing they are eligible for consumer redress under the terms of the order. The order also prohibits Fleet Finance and its successor companies, inter alia, from future violations of the TILA and Regulation Z and from various misrepresentations of credit costs and terms.

In *Federal Trade Commission v. Capital City Mortgage Corp.* ("Capital City Mortgage"),(11) litigation continued against a Washington, D.C. area mortgage company and its owner in this case alleging numerous violations of federal laws, inter alia, the TILA and Regulation Z and the FTC Act.(12) The complaint alleges, inter alia, that defendants violated the TILA and Regulation, and engaged in unfair or deceptive acts or practices in violation of the FTC Act, by, inter alia: 1) understating the annual percentage rate and finance charge; 2) failing to disclose or accurately disclose the payment schedule (including failing to disclose a balloon payment); and 3) failing to provide disclosures that accurately reflect the legal obligation. The complaint also alleges that defendants engaged in other deceptive or unfair practices in offering and extending credit and throughout the loans, in violation of the FTC Act, with the result that a number of borrowers were

overcharged on their loans, were defaulted, and had title to their homes or other property impaired or completely lost (along with the equity). The complaint asks the court to award, inter alia, the amount necessary to prevent unjust enrichment and consumer redress (including refunds of monies paid, disgorgement of ill-gotten gains, and rescission of contracts) and to permanently restrain defendants from future law violations. The discovery phase in the case ended on December 20, 1999; a trial date has not yet been set.(13)

C. *Lease and Credit Advertising Cases*

In *United States v. Mazda Motor of America, Inc.* ("Mazda"),(14) a consent decree was entered against a vehicle manufacturer settling charges that it violated a 1997 FTC order ("FTC order")(15) and various state orders in connection with its televised lease advertisements. Under the FTC order, Mazda was required, inter alia, to disclose important lease terms in advertisements clearly and conspicuously and as required by the CLA and Regulation M. According to the complaint, following issuance of the FTC order, Mazda ran important lease terms in televised advertisements in small and unreadable print, offset by distracting images or sounds, or that appeared on the screen for too short a time. Under the consent decree, Mazda is required to pay $5.25 million -- the largest civil penalty ever in a FTC consumer protection matter: $4.05 million in civil penalties for alleged violations of the FTC order and $1.2 million in fines and costs to 24 states as part of the settlement. Mazda is also required to provide its dealers with consumer education brochures on vehicle leasing for distribution to consumers for one year and to distribute, inter alia, copies of lease and credit regulations to its dealers. Under the consent decree, Mazda is also prohibited from

violating the CLA and Regulation M.

In *United States v. Suntrup Buick-Pontiac-GMC Truck, Inc.*, Suntrup Ford, and Thomas Suntrup ("Suntrup"), (16) a consent decree was entered against two St. Louis vehicle dealerships and their chief executive officer ("CEO") settling charges that defendants violated a 1998 FTC order ("FTC order")(17) in connection with their lease and credit advertisements. Under the FTC order, Suntrup was required to disclose important financial information in lease and credit advertisements "clearly and conspicuously" and as required by the CLA and Regulation M and the TILA and Regulation Z. According to the complaint, following issuance of the FTC order, Suntrup's vehicle leasing advertisements stated the amount of any payment or that any or no initial payment was required at lease inception but failed to disclose clearly and conspicuously required financial information, including the total amount due prior to lease inception, by, inter alia, using small type, short durations or distracting sounds or images, and also omitted certain required lease terms. In addition, the complaint alleged that Suntrup's vehicle credit advertisements offered just "$1 down" without disclosing required credit terms. Under the consent decree, Suntrup is required to pay a $40,000 civil penalty - the first ever collected by the Commission for such an order violation by a vehicle dealership or its CEO. Suntrup is also required for two years to make the brochure, "Keys to Vehicle Leasing,"(18) available to consumers who visit the dealerships.

In *Dell Computer Corp. ("Dell")*(19) and Micron *Electronics, Inc. ("Micron")*,(20) the Commission issued final decisions and orders against two computer leasing companies resolving charges that they violated the CLA and Regulation M and the FTC Act, by disseminating misleading advertisements for

consumer leases primarily in Internet promotions. The complaints in these cases charged, inter alia, that the companies disseminated deceptive lease advertisements that offered low monthly payment amounts and placed material cost information in unreadable fine print or an inconspicuous location or omitted such information altogether -- including, inter alia, that the monthly payments are components of lease offers, whether or not a security deposit is required, and/or the number and timing of scheduled payments. Under the orders in these cases, respondents must, inter alia, provide all the disclosures required by the CLA and Regulation M for lease advertisements "clearly and conspicuously," that is, in a clear, readable (or audible), and understandable manner. The orders also prohibit the companies from running advertisements that highlight low monthly payments, unless the promotions also state, inter alia, clearly and conspicuously, that: 1) the transaction is a lease; 2) the total amount due at lease signing; 3) whether or not a security deposit is required; and 4) the number, amount, and timing of scheduled payments. The orders also prohibit the companies from making any reference to a charge that is part of the total amount due at lease signing or that no such amount is due, unless the promotion also states with equal prominence the total amount due at lease inception. In addition, the orders require respondents to comply with all requirements of the CLA and Regulation M.

The Commission also issued for public comment consent agreements with six Philadelphia, Pennsylvania-area vehicle dealerships and their CEOs for violations of the CLA and/or TILA and FTC Act pertaining to deceptive lease and/or credit advertisements:(21) Northeast Auto Outlet, Inc. ("Northeast"),(22) Norristown Automobile Co. ("Norristown"),(23) Dunphy Nissan, Inc. ("Dunphy"),(24)

Marty Sussman Organization, Inc. ("Marty Sussman"),(25) Pacifico Ford, Inc. ("Pacifico Ford"),(26) and Pacifico Ardmore, Inc. ("Pacifico Ardmore").(27) These cases involve actions for omitting or burying in fine print key cost information in advertised lease and/or credit deals.

In all six cases, the complaints alleged deceptive vehicle lease advertisements, in violation of the FTC Act, either by failing to disclose and/or failing to disclose adequately essential lease information. The six dealerships and their CEOs were charged with hiding many costs associated with the lease in fine-print disclosures located far from the more prominent claims of low monthly payments or with omitting these costs. The complaints also alleged, inter alia: 1) that Dunphy misrepresented the amount due at lease inception by promoting low down payments or "$0 down," when additional fees were due at lease signing; 2) that Dunphy and Northeast represented that consumers could buy the advertised vehicle for a low monthly charge, while the offer was for a lease; 3) that Northeast misrepresented that the dealer's "double your down payment"offer was available for the advertised vehicles when it was not. In all six cases, the complaints also alleged that the lease advertisements used triggering terms under the CLA and Regulation M, but failed to disclose or failed to disclose clearly and conspicuously other required information, such as the total amount due at leasing signing, and that the promotions stated a down payment amount more prominently than the disclosure of the total amount due at lease signing.

In addition, the complaints charged that Dunphy, Norristown, Northeast and Pacifico Ardmore ran deceptive credit promotions in violation of the FTC Act, by failing to disclose and/or failing to disclose adequately critical credit terms, by

omitting required terms or placing this information in fine-print disclosures located far from the more prominent low down payment claims. The complaints against these four dealers also alleged that the credit advertisements used triggering under the TILA and Regulation Z, yet omitted or failed to disclose clearly and conspicuously required information. All six complaints also allege that the dealers' credit advertisements stated a rate of finance charge without stating that rate as an "APR," in violation of the TILA and Regulation Z.

The consent agreements in these six cases would require these dealerships and their CEOs, inter alia, to make clear and accurate cost disclosures in their lease and/or credit advertisements. In all six cases, the proposed orders would prohibit these entities from placing advertisements that state the amount of any payment due at lease inception (excluding the monthly payment) or the fact that any or no inception payment is due, without also disclosing with "equal prominence" the total amount due at lease inception. The proposed orders would also prohibit respondents from disseminating lease promotions that state the amount of any payment, or that any or no initial payment is required at lease inception, unless the advertisements also clearly and conspicuously disclose other required lease information, such as the total amount due at lease inception and whether or not the consumer must pay a security deposit. All respondents would also be required to comply with all provisions of the CLA and Regulation M. In addition: 1) Dunphy would be prohibited from misrepresenting the costs of leasing, including the amount due at lease inception; 2) Dunphy and Northeast would be prohibited from representing that the advertised terms apply to a cash or credit offer when, in fact, they apply only to lease a particular vehicle; and 3) Northeast

would be prohibited from misrepresenting the availability of any advertised offer. All respondents would also be required to comply with all provisions of the TILA and Regulation Z.

D. *Consumer and Business Education*

The Commission continues to view consumer and business education efforts as important to its enforcement activities. In 1999, in connection with continuing concerns about possible home equity fraud, the Commission issued a consumer publication to provide information to consumers considering home equity loans, "Need a Loan? Think Twice About Using Your Home as Collateral." In addition, the federal Interagency Task Force on Fair Lending, of which the Commission is a member, issued a consumer brochure to facilitate shopping and negotiating for a home mortgage, "Looking for the Best Mortgage: Shop, Compare, Negotiate."(28) The Commission staff also continued to participate in the Board-sponsored "Lease Education Program Team," involving the Board, Commission staff, and a coalition of entities (including consumer groups, state attorneys general and industry representatives), which developed various online educational materials and a computer program to enhance awareness and understanding of leasing. The Commission's above consumer protection materials were also made available to the public through the Commission's website at "www.ftc.gov."(29)

Equal Credit Opportunity Act

In 1999, the Commission obtained consent decrees against two vehicle finance companies for violations of the Equal Credit Opportunity Act ("ECOA") and its implementing Regulation B. Litigation continues in a case involving a

subprime mortgage lender. Those three cases are discussed below. Other enforcement efforts continue.

In *United States v. Franklin Acceptance Corporation* ("Franklin"),(30) a consent decree was entered settling allegations that a vehicle finance company discriminated against applicants on the basis of sex, marital status and the fact that an applicant's income derived from public assistance sources, and when taking adverse action on an application, failed to provide notice as required under the ECOA and the Fair Credit Reporting Act ("FCRA"). The complaint alleged that Franklin discriminated against applicants on the basis of sex and marital status by discounting or excluding from consideration the income of an applicant who received payments of child support. The complaint alleged that Franklin discriminated against applicants on the basis of marital status by failing to aggregate the incomes of unmarried co-applicants while aggregating the income of married co-applicants. The complaint alleged that Franklin discriminated against applicants who derived their income from public assistance by discounting or refusing to consider such income. In addition, the complaint alleged that, when taking adverse action on an application, Franklin failed to provide the applicant with written notification of the action taken, failed to disclose the specific reasons for the action taken or to disclose the applicant's right to request such reasons, and, when adverse action was based on a report from a consumer reporting agency, failed to provide notice as required under the FCRA. Under the consent decree, defendants agreed to pay a civil penalty of $800,000 and to the entry of a permanent injunction.

In *United States v. Ford Motor Credit Co.*,(31) a consent decree was entered resolving allegations that this vehicle

finance company discriminated in the pricing of its credit products against applicants on the basis of marital status. The complaint alleged that the company failed to aggregate the incomes of unmarried co-applicants while aggregating the income of married co-applicants with the result that unmarried co-applicants often paid more for credit. Under the consent decree, defendants agreed to pay $650,000 to a consumer redress program and to the entry of a permanent injunction.

Litigation continued in *Capital City Mortgage*,(32) alleging that the company and its owner violated the ECOA and Regulation B by: failing to take written applications for mortgage loans; failing to collect required information about the race or national origin, sex, marital status, and age of applicants; failed to provide rejected applicants with written notice of adverse action; and, when providing notice of adverse action, failed to provide applicants with the correct principal reason for the action taken or the correct name and address of the Commission, the federal agency that administers compliance with the ECOA with respect to defendants. The complaint seeks civil penalties and injunctive relief for the alleged violations of the ECOA and Regulation B.

In November 1999, the Commission and other federal agencies submitted a joint comment to the Board about Regulation B.(33) The comment was submitted in response to the Board's notice of proposed rulemaking with respect to Regulation B. In their comment, the agencies urged the Board to amend Regulation B to allow lenders voluntarily to collect information about the race and gender of applicants for non-mortgage credit. According to the comment, the current prohibition of collecting such information "inhibits the ability of financial service providers to learn about and respond to

market opportunities to provide credit to underserved communities. The prohibition makes it difficult for institutions to know whether products intended to expand access to credit, including to minorities, reach their intended customer base." The comment also urged the board to clarify that creditors may not discriminate on a prohibited basis in their preapplication marketing practices and to clarify how creditors may determine the need for special purpose credit programs.(34)

The Commission continued its consumer and business education efforts. The staff worked with other governmental agencies and with creditor and consumer organizations to increase awareness of and compliance with the ECOA. The Commission also continued its active participation in the Interagency Task Force on Fair Lending.

Electronic Fund Transfer Act

In 1999, the Commission continued its consumer and business education efforts in this area. The Commission issued a brochure, "Guide to Online Payments," providing information to consumers about different types of online payment systems and security features.(35)

II. AN ASSESSMENT OF THE EXTENT TO WHICH COMPLIANCE IS BEING ACHIEVED BY ENTITIES SUBJECT TO THE COMMISSION'S ENFORCEMENT AUTHORITY(36)

Truth in Lending Act and Consumer Leasing Act

This year, the Commission received, inter alia, numerous inquiries concerning home equity lending, including concerning consumer rights under HOEPA. Many mortgage brokers, and some online mortgage entities, requested materials regarding the requirements of Regulation Z. Many credit and lease advertisers requested information regarding Regulations Z and M. Some consumers requested information regarding their TILA rights concerning unauthorized transactions and error resolution, including for online transactions.

Equal Credit Opportunity Act

The Commission received various inquiries about fair lending and predatory lending issues. The Commission also received requests for information about ECOA from mortgage brokers.

Electronic Fund Transfer Act

The Commission received some requests from consumers for information about EFTA protections pertaining to point-of-sale debit transactions, including for unauthorized use and error resolution. The Commission continues to receive a small number of inquiries about these requirements in comparison to those under the credit and lease area.

III. ANY SUGGESTIONS FOR CHANGES IN THE ACTS OR THEIR IMPLEMENTING REGULATIONS

The Commission supports the Board's regulatory review of Regulation B. The Commission understands that the Board

may undertake a review of Regulation Z, following conclusion of its Regulation B review. In view of the diverse transactions and issues affected by Regulation Z, the Commission would also support any such effort in the future to update and clarify Regulation Z as well.

The Commission hopes that the information contained in this letter responds to your inquiry and will assist in preparation of the Board's Annual Report to Congress. If any other information would be useful or if you request additional assistance, please contact David Medine, Associate Director, Division of Financial Practices, at (202) 326-3025.

By direction of the Commission.

Robert Pitofsky Chairman

Endnotes:

1. In this report, HOEPA, which amends the TILA and is implemented by Regulation Z, is referenced separately. HOEPA provides special protections for consumers who obtain high-rate or high-fee loans secured by their principal dwellings by requiring creditors to provide certain material information at least three days before the loan is consummated, prohibiting the use of certain loan terms, and barring specified practices.

2. The Commission voted 4-0 to approve the settlements, with Commissioner Swindle concurring in part and dissenting in part.

3. No. CV 99-07782 WDK (C.D.Cal. Aug. 2, 1999).

4. No. 2-99-CV580G (D. Utah Aug. 23, 1999).

5. No. C99-1215 Z (W.D. Wash. Jul. 30, 1999).

6. No. 99-289 (E.D. Ky. Aug. 12, 1999).

7. No. 99 Civ. 5988 (S.D. N.Y. Jul. 30, 1999).

8. No. 3:99 CV-496-H (W.D. Ky. Aug. 5, 1999).

9. No. 2-99CV579G (D. Utah Aug. 23, 1999).

10. FTC Docket No. C-3899 (Oct. 5, 1999).

11. No. 98CV00237 (D.D.C. filed Jan. 29, 1998).

12. The complaint in this matter also alleges, inter alia,

violations of the Equal Credit Opportunity Act. See infra p.11.

13. The case is joined, for purposes of discovery, with a private lawsuit, Hargraves v. Capital City Mortgage Corp., No. 98CV1021 (D.D.C. filed Apr. 24, 1998).

14. No. SACV-99-1213 AHS (C.D. Cal. Oct. 7, 1999).

15. FTC Docket No. C-3714 (Feb. 6, 1997).

16. No. 4:99CV01746CEJ (E.D. Mo. Nov. 22, 1999).

17. FTC Docket No. C-3779 (Jan. 5, 1998).

18. This brochure was previously jointly developed by the FTC staff, Federal Reserve Board staff, and various industry representatives and consumer groups and explains, in simple terms, vehicle leasing transactions and costs.

19. FTC Docket No. C-3888 (July 28, 1999).

20. FTC Docket No. C-3887 (July 28, 1999).

21. The consent agreements were placed on the public record for public comment for sixty days, after which the Commission will decide whether to make them final. See 64 Fed. Reg. 68687 (Dec. 8, 1999).

22. FTC File No. 992 3080 (Dec. 2, 1999).

23. FTC File No. 992 3081 (Dec. 2, 1999).

24. FTC File No. 992 3082 (Dec. 2, 1999).

25. FTC File No. 992 3078 (Dec. 2, 1999).

26. FTC File No. 992 3079 (Dec. 2, 1999).

27. FTC File No. 992 3116 (Dec. 2, 1999).

28. The members of the Interagency Task Force include the: Department of Housing and Urban Development, Department of Justice, Department of the Treasury, Federal Deposit Insurance Corporation, Federal Housing Finance Board, Federal Reserve Board, Federal Trade Commission, National Credit Union Administration, Office of Federal Housing Enterprise Oversight, Office of the Comptroller of the Currency, and Office of Thrift Supervision.

29. Information concerning the Commission's enforcement actions and other activities discussed in this report are also available at this website.

30. No. 99-CV-2435 (E.D. Penn. May 14, 1999).

31. No. 99-75887 GEW (E.D. Mich. filed Dec. 9, 1999).

32. See supra note 11.

33. Letter from Commission, Department of Treasury, Department of Justice, Department of Housing and Urban Development, Office of the Comptroller of the Currency, Office of Thrift Supervision, Small Business Administration, and Office of Federal Housing Enterprise Oversight to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System dated November 15, 1999.

34. The Commission voted 3-1 to file this comment with the

Board, with Commissioner Swindle dissenting and issuing a separate statement.

35. This brochure was jointly developed by the Commission and America Online, Inc. ("AOL"). AOL was required to develop consumer education materials regarding online payment systems, pursuant to a final decision and order issued by the Commission (previously reported). See FTC Docket No. C-3787 (Mar. 24, 1998).

36. Among other things, the Commission is charged with enforcement of the FTC Act and various federal consumer financial laws and regulations, including the TILA, ECOA, and EFTA, with respect to most nonbank entities in the nation. It does not have data regarding the extent of compliance by these numerous entities with these requirements. In lieu thereof, the Commission is providing information regarding certain issues raised by consumers and/or business entities pertaining to these mandates.

APPENDIX 2

STATE OF SOUTH CAROLINA	)
	) IN ARBITRATION
COUNTY OF BARNWELL	)
	)
Daniel B. Lackey, George Buggs, Florine Buggs, Michael Highsmith, and Paula Johnson,	)
	)
Plaintiffs,	)
	) MEMORANDUM
v.	) OF GREEN TREE
	) FINANCIAL
Green Tree Financial Corporation.	) CORPORATION
	)
Defendant.	)
	)

INTRODUCTION

This memorandum is submitted on behalf of the Defendant Green Tree Financial Corporation (hereinafter Green Tree). The purpose of this memorandum is to address the single issue of whether an arbitration may proceed as a class action in the absence of specific language in the arbitration agreement permitting class treatment arbitration. Additional issues concerning class certification under Rule 23 and questions of the necessity for class treatment are reserved to be addressed at a later time if necessary.

Arbitration was compelled in this case pursuant to the Federal Arbitration Act (FAA) 9 USCA § 1 et. seq. Green Tree submits That federal law interpreting the FAA controls this issue and preempts stare law or regulation to the contrary. Green Tree submits further that the principle has been well established in the federal decisions dealing with or related to the issue that the parties may not be subjected to state class

action procedures in arbitration unless the arbitration agreement expressly permits class treatment in arbitration.

STATEMENT OF FACTS

Green Tree is a financial services company doing business nationwide. From the complaint it appears that the Plaintiffs *Highsmith, Johnson* and Buggs are *all individuals* who financed the purchase of mobile homes. The Plaintiff Lackey financed home improvements. The consumer financing paper in each transaction was assigned to Green Tree. Each of the transactions involved a mortgage an real property in South Carolina. However, the Highsmith and Lackey transactions took place in Georgia. The other Transactions took place in South Carolina.

Each of the named Plaintiffs executed a Retail Installment Sales Contract which included an agreement to submit all claims to arbitration. While the wording of the agreements were not identical, they each required arbitration and none of the arbitration agreements permit class treatment in arbitration. Attached hereto for the arbitrators convenience are affidavits filed with the Court in connection with previous proceedings identifying the financing agreements.

Green Tree moved in the Circuit Court to stay the litigation and compel arbitration. The motion to compel arbitration was denied. On appeal The Circuit Court's order was reversed by the Court of Appeals. The case was remanded to the Circuit Court for further proceedings.

SUMMARY OF ARGUMENT

1. The FAA supersedes state law and procedure and requires the enforcement of arbitration agreements according to their terms and no more, notwithstanding state law or procedure to the contrary.

2. State class action procedures may not be superimposed on an arbitration under the FAA unless the arbitration clause specifically provides for class action treatment.

ARGUMENT

The FAA reflects a "congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." Moses H. Cone Mem. Hosp. V. Mercury Constr. Corp., 460 U.S. 1, 24 (1983). The primary legislative purpose of the FAA is to assure the enforcement of arbitration agreements. Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985). While Congress recognized that enforcement of arbitration agreements would normally promote efficient and speedy dispute resolution, the cases are clear that promotion of efficiency is secondary to the enforcement of the terms of the arbitration agreement.

> We therefore are not persuaded by the argument that the conflict between two goals of the arbitration act - - enforcement of private agreements and encouragement of efficient and speedy dispute resolution must be resolved in favor of the latter in order to realize the intent of the drafters. The preeminent concern in passing the act was to enforce private

> agreements into which the parties had entered, and that concern requires that we vigorously enforce agreements to arbitrate even, if the result is 4, piecemeal" litigation, at least absent a countervailing policy manifested in another federal statute. ***

Id., p.221

There is no discretionary right in a trial court to refuse to enforce the arbitration agreement as written. Id. A court may not substitute its notions of fairness or judicial economy in place of the explicit terms of the agreement. As noted in Champ v. Siegel Trading Company, 55 F. 3d 269, 275 (7th Cir., 1995),

> The underlying motivation for the Federal Arbitration Act was to enforce the agreement of parties to arbitrate. Because the act was designed to overrule the historical refusal of the judiciary to enforce agreements to arbitrate, it follows that a court is not permitted to interfere with private arbitration agreements in order to impose its own view of speed and economy. This is the case even where the result would be the possibility of inefficient maintenance of separate proceedings.

See American Centennial Insurance Company v. National Casualty Company, 951 F.2d 107, 108 (6th Cir 1991). The South Carolina Supreme Court has recognized that the FAA preempts contrary state law. Soil Remediation Co. V. Nu-Wav Environmental, 317 S.C. 274, 476 S.E. 2d 149 (1996). Federal law therefore governs the enforcement of the FAA in both state and federal courts. Moses H. Cone Mem. Hosp., 460 U.S. at 24.

Section 4 of the FAA provides that when a court determines that an agreement to arbitrate exists, the court must order the parties to "proceed with the arbitration in accordance with the terms of the agreement." Parties to an arbitration agreement are entitled to have their agreement enforced "as they wrote it - and nothing more." Champ, 55 F.3d at 277. As noted in Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Georgiadis, 903 F.2d 109 (2d Cir. 1990), Congress "surely did not intend that the parties be able to disregard selected contractual obligations willy-nilly in order to choose an arbitral foram more convenient or more suited to a party's particular needs."

Along these lines, the United States Supreme Court noted that arbitration "is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit. Just as they may limit by contract the issues which they will arbitrate, so too may they specify by contract the rules under which that arbitration will be conducted." Volt Info. Sciences v. Bd. Of Trustees, 489 U.S. 468, 479 (1989). To hold otherwise would "fundamentally modify the terms of the parties' contract." Salvano v. Merrill Lynch, Pierce, Fenner & Smith. Inc., 85 N.Y. 2d 173, 647 N.E.2d 1298, 623 N.Y.S.2d 790 (1995) (refusing to order expedited arbitration because arbitration agreement contained no such provision). From the forgoing it is apparent that in order to determine whether this case may proceed in arbitration as a class action, the Arbitrator must resort to federal law, and state law and procedure contrary to federal law interpreting the FAA has no application. Cohen v. Wedbush, Noble, Cooke, Inc., 941 F.2d 282, 285 (9th Cir. 1985)

The decisions applying federal law have determined without apparent exception that state class action procedures may not be imposed on an arbitration under the FAA unless *the*

arbitration agreement specifically provides for class treatment. Champ, supra; Gammaro v. Thorp Discount, 828 F. Supp. 673 (D. Minn. 1993); McCarthy v. Providential Corp, 1994 WL 387852,1994 U.S. Dist. LEXIS 10122 (N.D. Cal. 1994); Randolph v. Green Tree Financial Corp. 991 F.Supp. 1410 (N.D. Ala. 1997).

Similarly, courts have held that other procedural devices such as consolidation of cases under Federal Rule 42 must also yield to the express language contained in an arbitration agreement, and cannot be imposed unless specifically allowed. American Centennial, 951 F.2d 107, In American Centennial, the Sixth Circuit Court of Appeals dismissed a petition for consolidation of arbitration proceedings on the ground that the arbitration agreements did not provide for consolidation. See also Government of United Kingdom v. Boling Co., 998 F.2d 68 (2d Cir., 1993) (reversing an order granting a motion for consolidation); Protective Life Ins. Corp v. Lincoln National Life Ins. Corporation, 873 F.2d 281 (11th Cir. 1989). (holding that parties may negotiate for and include provisions for consolidation of arbitration proceedings in their arbitration agreements, but if such provisions are absent, federal courts may not read them in. Id., p. 282.); McCarthy v. Providential Corporation, 1994 U.S. Dist. Lexis 10122 (D.C. Cal. 1994) (holding that class arbitration may not be ordered in the absence of a provision in an arbitration clause providing for arbitration on a class wide basis); see also Weverhaeuser Co. v. Western Seas, Shipping Co., 743 F.2d 635 (9th Cir. 1984), cert. denied, 469 U.S. 1061, 83 L. Ed, 2d 431, 105 S.Ct. 544 (1984) (parties may negotiate for and include provisions for consolidation of arbitration proceedings, but if they do not, court's cannot read such provisions into the agreement). Fundamentally, arbitration agreements must be enforced according to their specific terms and no others. Volt Info. Sciences v. Bd. of Trustees, 489 U.S. 468 (1989); Del E. Webb

Constr. v. Richardson Hosp. Auth., 823 F.2d 145 (5th Cir. 1987); Baesler v. Continental,Grain Co., 900 F.2d 1193 (8th Cir. 1990).

In *Champ*, the Seventh Circuit Court of Appeals rejected the argument That class arbitration is appropriate where the arbitration clause is silent on the issue- The Court stated that its "chief concern under the FAA is to enforce the parties arbitration (agreement) as they wrote it." To do otherwise would be to substitute the judgment of the court for the intent of the parries to the contract, contrary to the 46 overriding, goal' of the FAA to put arbitration agreements on equal footing with other contracts between private parries." 55 F.3d at 274, 275.

Cases allowing class arbitration under state law axe not applicable to enforcement of arbitration provisions under the FAA because of federal preemption over state law under the FAA. Episcopal Housing Corp, v. Federal Insurance Co., 269 S.C, 63) 1, 239 SE 2nd 647 (1977). Class action procedures may not be imposed on, an arbitration under
the FAA unless the arbitration provision specifically pen-nits class action treatment, and the arbitration provision in this case does not so provide.

The cases holding that class action procedures may *not* be superimposed on an arbitration clause enforceable under the FAA are based on fundamental principles of substantive contract law. Volt, 489 U.S. 468; Champ, 55 F. 3d 269. Class action rules are procedural devices permitting consolidation of matters properly before the court. Such procedural rules Should not be allowed to thwart the substantive contractual light of the parties to have individual disputes arbitrated, Nor can the procedural rules of class action be used as a method for the discovery of names and addresses of potential plaintiffs in

an effort to generate additional claims, "Class actions are provided only as a
means to enforce substantive law. Altering the substantive law to accommodate procedure would be to confuse the means for the ends - to sacrifice the goal for the going." Vernon v. Drexel, Burnham & Co., 52 Cal. App. 3 rd 706 (1975); see also Moses H. Cone Memorial Hosp. v. Mercury Construction Corp., 460 U.S. I (1982) (holding that an arbitration agreement must be enforced as written even though arbitration would result in bifurcated proceedings).

For a court to substitute its notions of fairness of judicial economy in place of the explicit terms of the agreement would "deprive them of the benefit of their bargain just as surely as if we refused to enforce their decision to arbitrate." Champ, 55 F.3d at 275. Reading such terms into an agreement would "disrupt the negotiated risk/benefit allocation and direct [the parties] to proceed with a different sort of arbitration," Id.

CONCLUSION

Under the FAA, the arbitration agreements involved in this case must be enforced according to their express terms, and no others. The arbitration agreements are silent on the issue of class treatment and no such procedure can therefore be imposed upon the proposition that class action parties. The overwhelming weight of authority stands for the treatment should not be permitted in this arbitration and that an order compelling class treatment is beyond the power of the arbitrator. Green Tree respectfully submits that the Plaintiffs' motion for class certification should be denied.

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